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PHD

An investigation of change in Japanese payment systems: comparison with the UK

Suda, Toshiko

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An Investigation of Change in Japanese Payment Systems: Comparison with the UK

Submitted by Toshiko Suda
For the degree of PhD
of the University of Bath
2004

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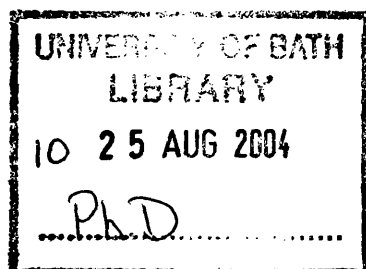
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Abstract

This thesis seeks to describe and understand the reasons for recent changes in Japanese payment systems. Comparisons are made with UK payment systems in order to help contextualise the changes. Such a comparison also helps identify the extent to which there may be convergence with, or continued divergence from, Anglo-Saxon countries.

The thesis identifies three basic factors that determine individual pay levels and constitute the payment system as the job, the market and the person. As a result, the Japanese payment system is identified as a person-, stock-, and organisation-based system, and the UK payment system is identified as a job-, flow-, and market-based system. However, recent surveys combined with original research demonstrate a change of the Japanese payment system in relation to these basic characteristics.

Using ten Japanese case studies, the author's research investigated the direction and extent of change, and how and why change is taking place. Eight case firms in the UK were also studied in order to make comparisons with the Japanese firms. The case studies reveal that basic characteristics have been changing in the Japanese case study firms, but there has been little change to the basic characteristics in the UK case study firms.

The case study findings demonstrate that in Japan, major changes to payment systems have been instigated because of shifting organisation and HRM strategies, which in turn are related to changes in Japan's economy and institutions. There is some evidence of a degree of convergence with the UK.

Table of Contents

1 Introduction	1
1.1 Reasons for conducting research	1
1.2 Objectives of research	3
1.3 Research framework	5
1.3.1 Adoption of international comparative study	5
1.3.2 Research subjects	6
(1) Sector and size	6
(2) Focus on individual pay determination and base-pay	6
1.4 Factors for analysis of payment systems	8
1.5 Organisation of thesis	9
 2 Characteristics and trends of payment systems in the UK	 13
2.1 Conditions for selection of survey data	13
2.2 Terminology	16
2.3 Job factor	18
2.3.1 History of job-related pay	18
2.3.2 Job evaluation	19
(1) Theoretical underpinnings of job evaluation	20
(2) Historical background and recent trend of job evaluation	20
(3) Problem of non-analytical job evaluation	21
2.3.3 Pay structure	22
2.4 Market factor	24
2.4.1 Concepts of market pay	24
2.4.2 Historical background and recent trends of market pay	24
2.5 Person factor	25
2.5.1 Classification of pay relating to person factor	25
2.5.1 History and trends of pay relating to individual performance	26
2.5.3 Individual performance-related pay	28
(1) Trends of individual performance-related pay	28
(2) Theoretical underpinnings and problems of individual performance-related pay	29
(3) Management view point for individual performance-related pay	30
2.5.3 Competency pay	31

(1) Origin of competency approach	31
(2) Trends of competency pay	32
(3) Reason for introduction of competency pay	33
(4) Relationship between performance management and competency approach	34
2.6 Summary	34
3 Characteristics and trends of payment systems in Japan and comparison of pay between Japan and the UK	36
3.1 Structure of this chapter	36
3.2 Terminology and concepts	37
3.3 Characteristics of base-pay systems in Japan	43
3.3.1 Elements of base-pay captured by surveys	44
3.3.2 Main characteristics of Japanese pay as person-related pay	46
(1) Characteristics of elements making up base-pay	46
(2) Historical background and recent trends of person-related pay	46
(3) Reasons for declining job-related pay	48
(4) <i>Model chingin</i> under person-related pay	49
3.3.3 <i>Shokunou shikaku seido</i>	49
(1) Recent trends of <i>shokunou shikaku seido</i>	49
(2) Methods to decide individual qualification grade	50
3.3.4 Pay structure	51
3.3.5 Annual pay increase system	52
(1) Elements of annual pay increase	52
(2) Elements of <i>teiki shoukyu</i>	53
3.3.6 Appraisal	54
(1) Concepts of <i>jinji hyouka</i> and <i>jinji kouka</i>	54
(2) Trends of <i>jinji hyouka</i> and <i>jinji kouka</i>	55
3.3.7 Section summary	55
3.4 Comparison of pay between Japan and the UK	56
3.4.1 Comparison on payment systems between Japan and the UK	56
(1) Characteristics of payment systems in Japan and the UK	56
(2) Relationship between type of payment systems and employment systems	60
3.4.2 Comparison of age-pay profiles between Japan and the UK	64
3.4.3 Age-pay profile of Japanese women	66

3.4.4 Age-pay profile by firm size	67
3.4.5 Pay profile by years of service	68
3.4.6 Characteristics of pay profile in Japan	68
3.4.7 Section summary	70
3.5 Economic approach to seniority-related pay	70
3.6 History of HRM in Japan	72
3.6.1 Until the end of the Second World War	72
3.6.2 Establishment of lifetime employment and seniority pay after the war	73
(1) History of lifetime employment	73
(2) Reason for spread of lifetime employment	73
(3) Introduction of formal seniority-related pay	75
3.6.3 Establishment of ability-based HRM	76
(1) Reasons for establishment of ability-based HRM after oil shock	76
(2) Reasons for choice of lifetime employment	77
3.7 Recent trends of payment systems in Japan	78
3.7.1 Historical trends and recent situation of seniority-related pay	78
3.7.2 Change of types of person factors relating to pay	80
3.7.3 Emphasis on output performance-related pay	80
(1) Trends of output performance-related pay	80
(2) Concepts of yearly salary system representing output performance-related pay	81
3.7.4 Introduction of job factor	81
3.7.5 Introduction of market pay	83
3.8 Summary	84
4 Theoretical framework of the research	86
4.1 Theoretical perspective adopted by the research	86
4.1.1 Open system or contingency perspective of organisations	86
4.1.2 Three perspectives on HRM	88
4.1.3 HRM perspective adopted by the research	90
4.1.4 Research questions	93
4.2 Convergence or divergence	93
4.3 Environmental factors affecting payment systems	96
4.3.1 Two perspectives on international comparative study	96
4.3.2. Specification of environmental factors	98

4.4 Characteristics of institutional theory and comparison with contingency theory	103
4.5 Characteristics of proximate social institutions and business systems in Japan and the UK	108
4.6 Summary	115
5 Research design and methods	117
5.1 Research methods	117
5.2 Conditions for selection of case study firms	119
5.3 Types of employees studied	122
5.4 Issues of validity and generalisability	123
5.4.1 Problem of generalisability from case studies	123
5.4.2 Theoretical criteria for selection of case study firms	124
5.5 Data gathering	128
5.5.1 Organisation level of payment systems studied	129
5.5.2 Data gathering areas	129
5.5.3 Data gathering methods	132
5.5.4 Information from sources other than case study firms	135
5.6: Research process	135
5.6.1 Access to case study firms	136
5.6.2 Further research processes	136
5.6.3 Amounts of information gathered	139
5.7 Summary	143
6 Description of payment systems in case study firms in Japan	145
6.1 Profiles of case study firms	146
6.2 Elements of base-pay	147
6.2.1 Characteristics of elements of base-pay	147
6.2.2 Change of elements of base-pay	150
(1) Abandonment and reduction of age-related pay	152
(2) Introduction of job factor	156
(3) Yearly salary system	159
(4) Output performance	162
(5) Competency	166
(6) Market factor	172

6.3 Pay structure and pay increase	174
6.3.1 Pay structure	174
6.3.2 Annual pay increase	177
6.4 Appraisal	177
6.4.1 Types of pay linked to appraisal	177
6.4.2 Change of link between appraisals and base-pay	181
6.4.3 Base-pay decrease system	183
6.4.4 Grade promotion system in person grade system	184
6.4.5 Grade demotion system	187
6.4.6 Change of appraisal procedure	188
6.5 Individual appraisal process	190
6.5.1 Formal individual pay review procedure	190
6.5.2 Performance appraisal	192
(1) Setting objectives	192
(2) Rating	195
6.5.3 Competency appraisal	197
6.5.4 Perception for pay	199
6.5.5 Coordination by HR function	202
6.6 Payment system in Company JT1	204
6.6.1 History and recent change in Company JT1	204
6.6.2 Main HRM policies between 1999 and 2001	205
6.6.3 Payment system for managers before the change	207
(1) Elements of monthly pay before the change	208
(2) Pay structure before the change	209
6.6.4 Payment system for managers after the change	212
(1) Elements of monthly pay after the change	212
(2) Pay structure after the change	215
6.6.5 Appraisal	216
(1) Major changes in the appraisal system	216
(2) Competency appraisal	219
6.6.6 Differences in payment system for non-managers from managers	220
6.6.7 Differences of payment system among non-managers	222
6.6.8 Operation in pay review and appraisal	224
6.6.9 Directions of future change after acquisition	229
6.7 Summary	233

7 Description of payment systems in case study firms in the UK	235
7.1 Profiles of case study firms	235
7.2 Organisation level of payment systems studied in case study firms	236
7.3 Elements of base-pay	238
7.3.1 Job factor	239
(1) Job evaluation	239
(2) Pay structure	245
7.3.2 Market factor	255
7.3.3 Person factor	258
(1) Output performance	258
(2) Competency	266
7.4 Individual performance review and pay review process	274
7.4.1 Formal individual pay review procedure	274
7.4.2 Performance management	275
(1) Setting objectives	276
(2) Performance review	277
7.4.3 Pay review	280
7.5 Payment system in Company BT2	282
7.5.1 Overall description on Company BT2	282
(1) History of Company BT2	282
(2) Change of organisation strategy	283
7.5.2 Overall description of the reward system in Company BT2	283
(1) Restructuring the financial reward structure on a global scale	283
(2) Purpose and principle of reward system in the UK	285
7.5.3 Base-pay	289
(1) Principle for base-pay determination	289
(2) Job factor	289
(3) Market factor	294
(4) Person factor	298
(5) Pay review	301
7.5.4 Other financial rewards	302
(1) Short Term Incentive Plan = STIP (annual cash bonus)	303
(2) Discretionary share options	304
7.5.5 Operation in pay review and performance review	305

7.6 Summary	x 310
8 Comparison of payment system in the case firms between Japan and the UK	312
8.1 Differences in payment systems between the case study firms in Japan and the UK	312
8.1.1 Differences in elements of base-pay	312
8.1.2 Differences in pay structure	314
8.1.3 Differences in performance review and pay review	316
(1) Differences between performance review and <i>jinji kouka</i>	317
(2) Differences of pay review	319
8.1.4 Differences in relationships between performance review and promotions, and <i>jinji kouka</i> and promotions	321
8.1.5 Differences in treatment for low contributors	322
8.2 Two types of payment system bundles	324
8.3 Change of payment systems in case study firms in Japan	335
8.3.1 Differences in case study firms from traditional Japanese payment system	335
8.3.2 Sequence of change in payment systems in case study firms	337
8.3.3 Differences in change stages amongst the Japanese case study firms	345
8.4 Changes of payment systems in case study firms in the UK	347
8.4.1 The main directions of changes in payment systems in case study firms in the UK	347
8.4.2 Differences in changes amongst the UK case study firms	348
8.5 Summary	350
9 Environmental changing forces for payment systems in case study firms	352
9.1 Main environmental forces and HRM and payment systems in the individual case study firms	352
9.1.1 Case study firms in Japan	352
9.1.2 Case study firms in the UK	361
9.2 Approach to the major environmental forces for change	368
9.3 Low context/contingency environmental change forces in case study firms	370
9.3.1 Influence of low context/contingency change forces in the Japanese case firms	370

9.3.2 Influence of low context/contingency change forces in the UK case firms	382
9.4 High context/institutional environmental change forces in case study firms	386
9.4.1 General trends in changes in HRM and payment systems	387
(1) Japanese case study firms	387
(2) UK case study firms	389
9.4.2 General trends in changes in type of organisation strategy	389
(1) Japanese case study firms	389
9.4.3 Change in proximate social institutions and business systems	392
(1) Japanese case study firms	392
9.5 External environmental forces for change that differentiate the extent of change	393
9.6 Changes in the three factors in proximate social institutions and business systems	397
9.6.1 Directions of changes of the three factors	398
(1) Financial system	398
(2) Shareholder structure	399
(3) Corporate governance structure	400
9.6.2 Origins of the three factors	400
(1) Financial system	401
(2) Shareholder structure	402
(3) Corporate governance structure	402
9.6.3 Possibility of change in the three factors	403
9.7 Environmental change forces that differentiate the change stages between Japanese case firms	404
9.8 Difference of influence by industrial sector	409
9.9 Summary	410
10 Conclusion	412
10.1 Major research findings	412
10.2 Generalisability of the research findings	416
10.3 Convergence or divergence between two types of payment systems	418
10.3.1 Unchanging aspect in payment systems in Japanese case study firms	418
10.3.2 Other differences between the payment systems of the case study firms in Japan and the UK	419

	xii
10.3.3 Changes in payment systems in the UK	420
10.4 Speculation on future direction	421
10.5 Future research	423
Bibliography	426
Appendix I	466
Appendix II	468
Appendix III	473
Appendix IV	490

List of Tables and Figures

Table 2-1	Number of grade obtained	23
Table 2-2	Range of band	23
Table 2-3	Performance pay: linking type of performance with unit of performance	26
Table 3-1	Use of each type of <i>kihonkyu chingin taikei</i> (elements of base-pay)	45
Table 3-2	Example of <i>chingin hyou</i> (pay table)	52
Figure 3-1	Japanese type of payment system	59
Figure 3-2	UK type of payment system	60
Figure 3-3	Average years of service by age group	62
Figure 3-4	Relationship between payment system and employment system in Japan	62
Figure 3-5	Relationship between payment system and employment system in the UK	63
Figure 3-6	Age-pay profiles in Japan and the UK	65
Table 3-3	Pay dispersal of monthly pay (<i>shoteinai chingin</i>) by age group in Japan	65
Table 3-4	Pay dispersal of weekly earnings by age group in the UK	66
Figure 3-7	Pay difference by firm size	67
Figure 3-8	Age-pay profile by firm size in Japan	67
Figure 3-9	Pay profiles by years of service	68
Figure 3-10	Average age and years of service	69
Figure 3-11	Historical trends of age-pay profiles	79
Figure 4-1	Model of Strategic Change and HRM	87
Table 4-1	Environmental factors in low context and high context perspectives	100-101
Table 4-2	Institutional factors	106
Table 5-1	Number of case firms in each industrial sector	126
Table 5-2	Examination of case study firms by theoretical sampling	126-128
Table 5-3	Number of interviewees in HR function	133
Table 5-4	Number of employee interviewees	134
Table 5-5	Research schedule and feedback to case firms	143
Table 6-1	Profiles of case firms in Japan	144-147

Table 6-2	Elements of base-pay (<i>kihonkyu chingin taikeri</i>) in case firms	149-150
Table 6-3	Recent change of elements of base-pay in case firms	151-152
Table 6-4	How to link between pay and competencies in case firms	167
Table 6-5	How to link between <i>shokunou youken</i> (criteria relating to job-related abilities) and pay, and type of competency profiles linking to pay in case firms	168
Table 6-6	Types of pay structure in case firms	176-177
Table 6-7	Type of appraisals linked to base-pay in case firms	178-179
Table 6-8	Type of appraisal linked to <i>shoyo</i> (biannual regular bonus) in case firms	179-180
Table 6-9	<i>Shikakukyu</i> (grade-related pay) increase/decrease rates by sub pay bands and rating categories	182
Table 6-10	Amounts of <i>shokunou seikakyu</i> (job-related ability and performance pay) paid monthly by grades and rating categories	183
Table 6-11	Grade structure in Company JO1	185
Table 6-12	Relationship between rating category and number point in each grade	186
Table 6-13	Sum of rating points required by grade promotion	186
Table 6-14	Number of HR and employee interviewees	191
Table 7-1	Profiles of case firms in the UK	235-236
Table 7-2	Main elements considered within determination of individual base-pay	238
Table 7-3	Job evaluation methods in case firms	240
Table 7-4	Pay structure in case firms	246-247
Table 7-5	Recent change in pay structures	248
Table 7-6	Type of competency profiles used in case firms	266
Table 7-7	Number of HR and employee interviewees	275
Table 7-8	Overall rating categories in case firms	277-278
Figure 8-1	Japanese type of payment system as a bundle and its relationship with the employment system	334
Figure 8-2	UK type of payment system as a bundle and its relationship with the employment system	335
Table 8-1	Amounts of money for annual pay increase as age-related pay	338

Table 8-2	Amounts of money for annual pay increase as years of service pay	339
Table 8-3	Amounts of annual pay increase money as job-related ability pay	339
Table 8-4	Average of amounts of money for annual pay increase for non-managers	340
Figure 8-3	Change on Japanese type of payment system as a bundle and relationship with the employment system	344
Table 8-5	Stage of change in payment systems in Japanese case firms	345
Table 8-6	Stage of change in payment systems in the UK case firms	348
Table 9-1	Low context/contingency environmental change forces in the Japanese case firms	371-372
Table 9-2	Low context/contingency environmental change forces in the UK case firms	382-383
Table 9-3	High context/institutional environmental change forces in the Japanese case firms	386
Table 9-4	High context/institutional environmental change forces in the UK case firms	386
Figure 9-1	Relationships between external and internal change forces, and change of payment system in case firms in Japan and the UK	397
Table 9-5	Proportion of stable/cross shareholding	400
Figure 10-1	Change diffusion process	416
Figure 10-2	Relationships between external changing forces	422

Chapter 1: Introduction

1.1 Reasons for conducting research

There have been strong debates on Human Resource Management (HRM) issues in Japan during the prolonged recession since the 1990s and evaluation of Japanese management including HRM has changed. From the 1980s up to the early 1990s, the strengths of Japanese management especially in operations and HRM areas, were emphasised by western researchers. The introduction of Japanese management (Japanization) was a focus of the period. Lifetime employment, seniority systems and enterprise trade unions -- the three-pillars -- are often cited as characteristics of Japanese HRM and these were celebrated in the west. Among the three pillars, the seniority system of pay¹ and promotion has been the most strongly criticised. There are two aspects making up seniority; age and years of service. In the pay area, Japan has the second steepest age-pay profile² and the steepest years of service profile in comparison with five advanced nations -- UK, US, Japan, Germany and France (Japan Institute of Labour 2002a).

While there are various criticisms of the seniority system, the basic problem identified is that as seniority systems presuppose organisational expansion, the system must change in a period of low growth. Japan realised high economic growth in the past as a catch-up economy. However, since Japan is now one of the most advanced economies, a return to high economic growth cannot be expected, even if Japan recovers from the current economic slowdown. Hence, the popular view is that seniority systems that presuppose organisational expansion are no longer suited to the current economic position.

In fact, Japanese firms have considered seniority systems problematic for many years. For example, in a survey in 1977 by Hitachi Research Institute (cited in Harada 1988), 86.5% of firms answered that the seniority system would change. In contrast, firms predicting changes in lifetime employment and enterprise unions were as low as 19.7% and 6.8% respectively. Hence, it is clear that changes to seniority systems were already

¹ A definition of 'pay' will be indicated in section 2.1 in chapter 2.

² Pay profile expresses how pay levels change according to age and years of service (Seike 2003). Pay profile was firstly presented by Becker (1975a, 1975b).

being widely considered by the 1970s. Further, *nouryoku*³ *shugi jinji* (ability-based HRM) became a popular topic in the 1960s. The proposal on ability-based HRM by Nikkeiren (1969) shows this. Although seniority pay is often cited as a characteristic of Japanese pay, authors note (Koike 1993, 1994, 1999, Oliver and Wilkinson 1992) that pay in Japan is not pure seniority pay, but includes aspects of merit⁴. In fact, in a study by Sparrow et al (1994), Japan was given the highest score for the link between pay and individual performance. Nonetheless, the importance of seniority pay in Japan is shown by international comparison. Hence, the problem is why many Japanese firms have continued with the seniority pay despite the fact that many firms have perceived the need for changes.

However, the situation with the seniority system seems to have changed since the mid 1990s according to much survey data. Further, recent surveys tend to treat this trend as being a presupposition, and investigate the direction on HRM as being predominantly based on individual contribution.

Further, some qualitatively different aspects are found between the past change and the current change in Japanese HRM. Two differences are exemplified. Firstly, *seika* or *gyouseki shugi jinji* (output performance- or result-based HRM) has become popular since the 1990s. Ability-based and output performance-based HRM are conceptually different, since the former focuses on personal input and the latter focuses on personal output. Ability-based HRM has been wide spread for a long time, and output performance-based HRM is a relatively new idea, which spread rapidly in the 1990s (Kusuda 1994, 2001, Oshio 2001). HRM policies such as direct link between *gyouseki kouka* (performance appraisal) and MBO (Management by Objective), *nenpou sei* (yearly salary system) and *seikakyu* (performance-related pay) are considered to be output performance-based HRM policies.

The second difference is the change in policies for lifetime employment. Internal labour market theory suggests that pay increases relating to years of service will increase under long term employment. Comparing internationally, Japan, Germany and France, which

³ English words corresponding to '*nouryoku*' include such as ability, capability, capacity and competence. The paper uses 'ability' as English expression for '*nouryoku*'.

⁴ Tanaka (1988) discusses that word '*nenkou*' (seniority) is *nen* (age) and *kou* (merit) not *kou* (merit) by *nen* (age) in HRM context, although *nenkou* means merit by age as meaning of the word.

have longer years of service, have steeper pay profiles relating to years of service than the UK and US (Japan Institute of Labour 2002a).

Shirking theory, based on the agency hypothesis, suggests that seniority pay is effective in prevention of shirking by workers. This is because if workers are dismissed due to exposure of their shirking, they lose large amounts of benefits under the seniority pay system (Lazear 1981, 1998). If long term employment without a seniority system is operated, many workers may shirk under high job security. This is the worst scenario for management. Even in an intuitive sense, it is hardly considered that long term employment without a seniority system functions effectively, because workers are unlikely to be motivated to work hard under long term employment without a seniority system. Therefore, the seniority system and long term employment are closely related to each other. One cannot change only one side without change to the other. Recent surveys reveal changes in employment policy. For example, the series of *Koyou Kanri Chousa* (Survey of Employment Management)⁵ by the MHWL⁶ capture the change since the 1990s. 51% of respondents with more than 5,000 employees answered that we maintain lifetime employment in the 1993 survey (MHLW 1993) and this answer decreased to 14.6% in the 2001 survey (MHLW 2001a).

These situations motivated the author to conduct research into recent changes in the seniority system in Japan. The investigation of the reason why changes are being made and the nature of those changes is the major motivation for conducting research.

1.2 Objectives of research

The objective of the research is to investigate the directions and extent of change in the pay area, with a focus on payment systems. HRM is generally viewed within and outside Japan as one of the most significant characteristics in Japanese management. Further, the seniority system is one of the main characteristics that represent the so-called three pillars of Japanese HRM. An understanding of the direction and extent

⁵ There are many surveys about employment policy by firms such as surveys by the Institute of Labour Administration, Nikkeiren and JPCSED (Japan Productivity Centre for Socio Economic Development). Among these surveys, the Survey of Employment Management has the largest scale and highest response rate. In the 2001 survey, subjects were 5,800 firms and the response rate was 73.9%.

⁶ The Ministry of Labour restructured into the Ministry of Health, Labour and Welfare (MHLW) in 2000. This thesis uses the name of MHLW and includes data from before 2000.

of change in seniority systems is important in order to capture the direction and extent of change in the Japanese HRM, and pay is one of the two major areas in the seniority system.

The research focuses on payment systems⁷ that is concerned with the way in which pay decisions are made. Investigation of payment systems is necessary in order to reveal the reason for changes and the mechanisms of changes in seniority pay in Japan. The decision on what type of payment system is adapted is a 'strategic decisions' (Child 1972) by each firm. If payment systems in Japan are changing, the nature of the strategic decision by each firm leading the change is an interesting research subject. The research will seek reasons for (why change occurs) and mechanisms of (how change occurs) change in Japanese management by focusing on the payment system.

Identification of the basic characteristics of the Japanese payment system is the starting point for an investigation of the change. After the identification of the basic characteristics, the research will investigate the direction and extent of the change. The critical question is whether there is a change in basic characteristics.

In order to achieve these research objectives, the research addressed some concrete questions as follows.

- What are the basic characteristics of the Japanese payment system?
- Is the payment system in Japan changing?
- If it is changing, what aspects are changing, and to what extent are they changing?
- Does the change of the payment system include change in the basic characteristics of the Japanese payment system?
- Why and how does the Japanese payment system change?

While the research questions focus on change, they also consider aspects of continuity. Hence, the following questions will be investigated.

- In what aspect and to what extent does the Japanese payment system not change?

⁷ A definition of 'payment system' is indicated in section 2.1 in chapter 2. There are two terms in Japanese that correspond to payment system in English: *chingin taikei* and *chingin seido*. Definitions of the two terms are provided in section 3.2 in chapter 3 and Appendix IV. The thesis chooses *chingin seido* as equivalent term of payment system rather than *chingin taikei*.

- Why does the Japanese payment system not change?

The research investigates these research questions through comparison with the UK payment system. Therefore, the research asks the same research questions in relations to the UK payment system.

Whilst the research questions are presented here, the thesis will further develop these research questions based on the theoretical framework of this research in chapter 4.

1.3 Research framework

1.3.1 Adoption of international comparative study

The approach used in this research is the comparison of payment systems between Japan and the UK. The research can examine payment systems in Japan more objectively by international comparison. The main reasons why the research uses international comparison and uses UK firms as a means of comparison are two-fold.

Firstly, international comparison can reveal not only perceived characteristics of the payment system in Japanese firms, but also hidden or non-perceived characteristics. Institutional theory assumes that once persons are familiarised in a social system, they are unlikely to be conscious of the characteristics involved in the system, as they are taken-for-granted (DiMaggio and Powell 1991, Scott 1998). Following this assumption of institutional theory, if only one society is studied, long used and habituated characteristics of a social system cannot be discovered. International comparison is effective to overcome this limitation and can create a fuller picture of the social entities studied (Bamber and Lansbury 1987, Bean 1994). Kahn-Freund (1979) stated that “if one’s environment never changes in the course of one’s life, one tends to assume that an institution, a doctrine, a practice, a tradition, is inevitable and universal, while in fact it may be the outcome of specific social, historical or geographical conditions of the country” (Kahn-Freund 1979:3p cited in Bamber and Lansbury 1987:9p). We cannot objectively judge characteristics of a social system formed by the particular conditions of the country without reference to other social systems.

Secondly, the UK business system, including the HRM, is often characterised as the

opposite of Japan's. Some authors classify the employment systems of advanced countries into two systems. Whitley (1992a) distinguishes between market-based systems and organisation-based systems. Dore (1989) similarly distinguishes between market-oriented systems and organisation-oriented systems. Albert (1992) distinguishes between Anglo-Saxon type and Alpine/Rhein type. Marginson and Sisson (1994) discuss the Anglo-American outsider system and the Continental European and Japanese insider system. The UK is categorised by the former system and Japan by the latter. The UK has very different characteristics to the Japanese system, many being opposite. Therefore, a large number of taken-for-granted aspects can be revealed by comparison between these two systems. The research can fully utilise the strengths of international comparative study by comparison with the payment system in the UK.

1.3.2 Research subjects

(1) Sector and size

The subjects of this research are limited to large private sector firms. The public sector is very different and would demand a separate study. The objective of the research is to analyse the directions of Japanese HRM under the prolonged economic downturn since the 1990s. The research addresses the direction and extent of change of Japanese HRM by focusing on the payment system as an HRM area. Hence, the private sector is suitable as the research target. Concerning the reasons for the choice of large firms, HRM policies tend to differ with firm size (Marginson 1984, Fisher 1995). In particular, the differences in large and small firms' HRM are marked in Japan (Oliver and Wilkinson 1992). Large firms have stronger lifetime employment, enterprise trade unions and seniority systems. Smaller firms place less emphasis on these.

(2) Focus on individual pay determination and base-pay

It is important to set appropriate areas of pay or *chingin*⁸ as the targets of the research, because once the areas are selected, sufficient analysis will be required for the selected areas. However, if the research covers many areas of pays or *chingin*, it would be impossible to achieve sufficient analysis, because pay include many areas. Here, two

⁸ *Chingin* is the most equivalent concept of pay in English. A definition of *chingin* is indicated in section 3.2 in chapter 3 and Appendix IV. This thesis expresses *chingin* as pay in English.

types of area concerning pay are considered to limit areas of the research.

The first is focusing on individual pay determination, not the collective aspect of pay determination such as collective bargaining structures and process. Whereas collective bargaining is often studied in research on pay, this research does not focus on collective bargaining in order to make the research focus clear. Collective bargaining is too large a topic to be treated as one area in one piece of research. The reason for the focus on individual pay determination is that Japanese firms have been increasingly emphasising the individualistic aspect of pay determination and emphasising less the collective aspect of pay determination, as much survey data shows. Although this research does not focus on collective bargaining, the research gathered the data on collective bargaining in case study firms (conducted as the primary data gathering) in order to capture a whole picture of pay and/or payment systems in the case study firms.

The second is focusing on base-pay⁹ and *kihonkyu*¹⁰. Base-pay in the UK and *kihonkyu* in Japan constitute the largest proportion of total pay. In the case of the UK, according to the New Earnings Survey (2000) about 90 % of annual income comes from base-pay. In Japan, around 60% of annual income comes from base-pay (Sasajima 2001a, Koyanagi 1998). Although the proportion of base-pay against annual income is relatively small in Japan, base-pay is the basis for other financial rewards such as *shoyo* (biannual regular bonuses)¹¹. If these financial rewards are included, about 80% of annual income is determined by base-pay (Mitani 1997). In the UK, base-pay is also the basis of other financial rewards such as cash based profit sharing, share options and occupational pensions. Hence, base-pay is the largest and most important part of pay and is the basis of most other pay or financial rewards. Further, base-pay systems represent basic characteristics of payment systems in the two countries. Therefore, even though the thesis focuses the discussion on base-pay, the discussion effectively covers the most important issues of pay and payment systems. The author judges that a focus on base-pay systems is better than including other areas of pays in order that the discussion sufficiently covers important issues. Nonetheless, it is important to note that the research gathered data in other areas of pays and financial rewards in the two

⁹ Definition of base-pay is indicated in section 2.1 in chapter 2.

¹⁰ *Kihonkyu* is the nearest equivalent concept to base-pay in English. A definition of *kihonkyu* is provided in section 3.2 in chapter 3 and Appendix IV. This thesis expresses *kihonkyu* as base-pay in English.

¹¹ *Shoyo* (biannual regular bonus) in Japan is described in section 3.2 in chapter 3 and Appendix IV.

countries in order to capture the whole picture of the payment systems and financial reward systems for both the general situation (secondary data) and the case study firms (primary data source).

1.4 Factors for analysis of payment systems

This study identifies three factors -- job, market and person -- as basic factors that determine individual pay levels and the construction of the payment system, and analyses the basic characteristics of Japanese and UK payment systems using these three factors. The reasons why the three factors determine individual pay levels and payment systems are described below. It is noted that the following characterisations are based on ideal types. In later chapters, the thesis will assess payment system practices in Japan and the UK organisations against these ideal types.

Labour markets are generally divided into two types: external labour markets and internal labour markets (Williamson 1975, 1985, Elliott 1991, Doeringer and Piore 1971, Kerr 1977). The market set in this research as the factor for analysis of payment system is mainly the external labour market. According to economic theory, pay levels of individuals are determined by the value of the job and the person in the market place and by the organisation (Dunlop 1964, Williamson 1975, Elliot 1991). In the internal labour market, the payment system, including pay structure¹², is used as a component to determine pay levels of individuals.

There are two basic types of pay structure: job-based and person-based. In many advanced countries including the UK, the job-based pay structure is popular (Lawler 1990, 2000, Milkovich and Newman 1999, 2002). The person-based pay structure is popular in Japan (Koike 1994, 1999, Nagano 1996, Sasajima 1997). In the job-based structure, the pay rates may be determined by reference to relative internal value as established by job evaluation and external relativities as established by market pay data (Armstrong and Murlis 1998, Milkovich and Newman 1999, 2002, Gomez-Mejia and Balkin 1992). Thus, the job and the market are the factors that determine pay structures in the job-based pay structure. In the person-based pay structure, personal performance and personal attributes such as skills, knowledge and behaviour determine pay rates and

¹² Pay structure is "the array of pay rates for different jobs within a single organisation" (Milkovich and Newman 2002: 644p).

pay structure (Lawler 1990 2000, Milkovich and Newman 1999, 2002, Sasajima 2001a, Koyanagi 1998). Hence, in theory personal value based on internal and external relativity determine pay levels. However, as market pay rates for personal elements are not established (Lawler 1990, Schuster and Zingheim 1992), market pay rates do not directly influence individual pay rates. As we will be explain later.

Pay levels of individuals increase within a pay grade or between pay grades according to individual performance¹³ or time in the job. Therefore, the factor considered in payment systems is the person (performance and time). At the same time, market rates of jobs are often considered for determination of pay increase rates (Armstrong and Murlis 1998, Lynch 2000, IRS 2001a). Promotion often accompanies pay increases. Promotion, which means job promotion in the job grade system and person grade promotion in the person grade system, often accompanies pay increases. As person factors such as skills and knowledge required by jobs are specified in the job-based system, promotion on jobs accompanies as alignment of person factors in the job-based system (Gibson et al. 1994, Cascio 1998). That is, job, person and market determine the pay increase in the job-based system.

In Japan where the person-based system is popular, pay increases are determined by person factor such as time and individual contribution. As pay increases are determined through *jinji kouka* (appraisal) for most employees, individual merit or contribution is considered in most cases (Koike 1993, 1994, 1999, Mitani 1997). Market pay rates do not directly influence individual pay increases, since market pay rates are not established¹⁴. Regarding pay increases by promotion in the person-based system, as grade promotion is loosely rather than directly, related to job promotion (Institute of Labour Administration 1996), person factors directly determine promotion, not job factors.

1.5 Organisation of thesis

The thesis consists of ten chapters including this chapter. Chapters 2 and 3 introduce the characteristics and trends of payment systems in the UK and Japan, based on existing

¹³ As will be discussed in chapter 2, this thesis uses term 'contribution' that includes both output and input aspects of the person factor. But term 'performance' is used in this part to express both input and output aspects of the person factor.

¹⁴ 'Market pay' in Japan is described in section 3.2.2 in chapter 3 and Appendix IV.

literature and survey data. Although it might be expected that such a thesis would begin with a presentation of the Japanese payment system, the thesis firstly presents the UK system for two reasons. The first is to facilitate the understanding of British readers. The second is to make the discussion flow better. Chapter 3 includes a comparison of pay profiles and payment systems between the two countries. The comparison of payment systems identifies three basic characteristics of the two payment systems. The Japanese system is a person-, stock- and organisation-based payment system, and the UK system is a job-, flow- and market-based payment system.

Chapter 4 establishes research questions and discusses the main theoretical framework of the thesis. Theoretical perspectives adopted by the research are open systems or contingency perspective of the overall behaviour of firms. There are two basic perspectives for organisations as a system: closed system and open system. The open system considers that the system exists within a broader supra system and the system is characterised by an exchange with its environment (Kast and Rosenzweig 1985, Burrell and Morgan 1979, Yokoyama 2001). The contingency perspective regards organisations as open system with a mutual relationship with their environment (Tosi and Hamner 1977, Kast and Rosenzweig 1985, Burrell and Morgan 1979, Lawrence and Lorsch 1977). The research adopts the open system, contingency perspective for overall organisational behaviour. Further, the research adopts a configuration perspective for HRM and payment systems. The configuration perspective entails that a specific combination of HRM policies can be identified that generate higher business performance, but that these combinations will vary according to organisational context (Richardson and Thompson 1999). By adoption of the above two types of perspectives, this research focuses on relationships between environmental factors and payment systems. That is, what, how and why environmental factors influence the formation of particular types of payment system configuration. Further, if payment systems are changing, what, how and why environmental factors influence change of payment systems is investigated.

Further, chapter 4 specifies environmental factors. At first, the thesis adopts the low context and high context perspectives as articulated by Child (2000) as the theoretical framework for consideration of environmental factors in international comparative study. The low context perspective minimises the relevance of national distinctiveness and the high context perspective emphasises national differences of management and

organisations. Further, contingency theory and institutional theory are identified as theoretical background for low context and high context perspectives respectively. As a result, the research investigates change of payment systems in Japan and the UK as relationships with low context/contingency factors and high context/institutional factors.

Chapter 5 identifies case studies as the primary data gathering method. The research process is described in this chapter.

Chapters 6 and 7 describe payment systems in the case study firms in Japan and the UK.

Then chapter 8 points out differences between payment systems in the Japanese and the UK case firms, and discusses the three significant differences between the two types of payment systems found through case studies as being 'difference of time span for sense of equity', 'difference for degree of centralisation for individual pay determination' and 'types of psychological contracts for pay'. These three differences support and increase effectiveness of the basic characteristics of the Japanese payment system as person-, organisation- and stock-based and the UK payment system as job-, market- and flow-based identified in chapter 3. While the author found these differences through case study evidence, these three differences can be also explained by the three basic characteristics. Therefore, the three differences are consequences of the three basic characteristics in each type of payment system at the same time the three differences support and increase effectiveness of the basic characteristics involved in each type. Further, chapter 8 discusses changes to payment systems in the two countries. While payment systems in both countries are changing, there are changes in the basic characteristics on the Japanese side, but not on the UK side.

Chapter 9 identifies the environmental forces for the payment system change in terms of low context/contingency factors and high context/institutional factors. Then, the thesis analyses reasons why the payment system in Japan is changing more than in the UK from the relationships with environmental change forces. Environmental forces on the two sides are compared in order to explain for the greater extent of change on the Japanese side. As a result, the thesis found that in Japan, national economic structure and social institutional context have been changing and functioning as change forces for payment systems in Japan, but in the UK, the main dynamic forces are market factors such as increased competition, and changes in national economic structure and social

institutional context are hardly recognised. That is to say, in Japan, social structure in both economic and institutional factors is changing more than in the UK. The thesis argues that this is the reason why Japanese payment system is changing more than UK payment system in relationships with external environmental factors.

Chapter 9 then examines environmental change forces that differentiate the extent of change between the Japanese case firms. This examination is not the main purpose for the examination of environmental change forces on how and why they encourage changes in payment systems in the case firms. Nonetheless, the author considers that this examination is worthwhile at least to some extent. For example, identification of environmental change forces that differentiate the extent of change in the Japanese case firms can reveal change diffusion processes of payment systems in Japan. As a result, three environmental factors are established that can differentiate the extent of the change between Japanese case firms as 'change of shareholder structure towards increasing foreign shareholder', 'strong link between organisation strategy and reward policy' and 'change of employment policy towards reduction of lifetime employment'. All three factors are internal factors. Although many environmental change forces are differentiated by industrial sectors, the research did not find that the industrial sector differentiates the extent of the payment system change.

Chapter 10 firstly summarises the main research findings. Then, chapter 10 considers some factors in order to conclude this research including diffusion processes of the payment system change, generalisability of the major research findings, and convergence or divergence of relationships between Japanese payment systems and UK payment systems. Furthermore, the author speculates the future direction of Japanese payment systems. Whilst this research found major changes occurring in Japanese payment systems, whether these changes will continue or not is subject to speculation.

Chapter 2: Characteristics and trends of payment systems in the UK

This chapter examines existing knowledge on characteristics and trends in payment systems in the UK. While discussing prevalent practices, reference is made to the assumptions which underpin and legitimate their use.

The research itself concerns changes of payment systems in large Japanese firms. Hence, starting with discussion of payment systems in Japan may be considered the normal approach. However, characteristics of payment systems in the UK are presented first for the two main reasons. The first is to facilitate understanding for British readers. The Japanese payment system is very different from the UK system, and its details are not well articulated in the existing English literature. The author feels that understanding may be facilitated if it is described with reference to the UK system.

The second is to make the discussion flow better. This is because payment systems are analysed by reference of three factors -- job, market and person. The UK case can be clearly analysed by the three factors, but the Japanese case cannot, due to lack of direct consideration of job and market factors for individual pay determination in many cases. The reasons why job and market factors do not directly relate to individual pay determination in Japan will be discussed. Further, whereas job and market factors have not been directly related to the payment system in Japan, the situation has recently been changing. The changing aspect will be also discussed in the Japanese part. Moreover, the Japanese payment system may be more complicated than the UK payment system. Hence considering the UK case first may help facilitate understanding of the more complex Japanese case.

2.1 Conditions for selection of survey data

Whereas surveys and/or case studies used in this thesis are limited to data gathered in the UK, American literature is included in the theoretical discussion due to the small difference in payment systems between the US and the UK. Moreover, as this research targets large private sector firm, the thesis focuses on survey data on large private sector firms as much as possible¹⁵.

¹⁵ Among the large firms, the research sets the targets as firms employing more than 1,000. The reason is discussed in chapter 5.

The author also considered some other conditions for choice of survey data in order to increase the validity of data (in terms of both internal validity¹⁶ and external validity¹⁷) that are used to show recent trends in UK payment systems. The first is to use more than two types of surveys. This condition is used for many issues including job evaluation methods, market pay, performance management, individual performance-related pay (IPRP) and competency pay. The second is to use survey data that covers a large number of subjects and high response rates as far as possible. This condition is applied to the New Earnings Survey used for incentive pay for blue collar workers (various data in New Earnings Survey are also used to indicate pay profiles in the UK in chapter 3). Further a survey by CIPD (1997b) that is used for analysis of differences in use of IPRP by sector (public and private), organisation size (over 1,000 employees and below 1,000 employees) and employee level (management and non-management) has a relatively large number of subjects and a high response rate. Subjects of the CIPD survey were 10,000 organisations, and 1,158 organisations responded to the survey (response rate 23%). These figures are relatively high compared with many other surveys. The third condition is to reduce respondent bias as much as possible. This condition is applied to a survey by CIPD (1999) about broadbanding pay structures. The conclusion of the CIPD survey is different from other surveys whose rates for use of broadbanding pay structures are generally small, for example 17.7% (IRS 1999b), 19.4% (IRS 2001a) and 37% (Industrial Society 1996). In contrast, the CIPD survey concluded that broadbanding pay structures are the most common, and that traditional pay structures are now far less popular. The author considered that one of the reasons for this difference may be the difference of data gathering methods. The CIPD survey asked about the number of bands and range of bands, while other surveys asked the respondents to choose the type of pay structure, or asked whether they use broadbanding or not. Therefore, interpretation by each respondent is inevitably included for judgement on the type of pay structure they use. This can decrease internal validity.

¹⁶ Many researchers (Seale 1999, Yin 1994, Maxwell 1992, 1996, Schwab 1999, Gill and Johnson 1997, Litwin 1995) discuss internal validity or construct validity, or more specific types such as face validity, content validity, convergent validity and discriminant validity. Interpretation of internal or construct validity is identified slightly different among the authors. This thesis uses the simple definition of “the extent to which conclusion regarding cause and effect are warranted” (Gill and Johnson 1997:179p).

¹⁷ Many researchers also discuss external validity. This thesis uses the definition of “the extent to which can be generalised or extrapolated beyond the immediate research sample or setting in which the research took place” (Gill and Johnson 1997:128p). External validity is also called as generalisability (Gill and Johnson 1997, Yin 1994, Maxwell 1992, 1996).

Further, the author knew that interpretation of broadbanding differs by practitioner through case studies conducted by the author in the process of this piece of the research. For example, one interviewee answered that the pay structure is broadly banded but not broadbanding, because the pay band is not closely related to career development. The author understood his reason because she recognised that several definitions of broadbanding are provided for practitioners (Gilbert and Abosch 1996, CIPD 1997a, Armstrong and Murlis 1998). The other interviewees in the case study firms also expressed divergent opinions about the definition of broadbanding (the same situation happened for other issues such as IPRP, competency, competency pay as divergence of opinion about definitions of these issues). For these reasons, the other surveys can misrepresent the trends that many organisations change their pay structure towards reduction of pay bands. In fact, several surveys such as Gee Publication (1998), IRS (2001a) and CIPD (1997b) found a reduction of number of pay bands as the recent trend. Hence, the author judged the CIPD (1999) survey as the best to show the trends of broadbanding.

The author also considered the method of presentation of survey data. This is applied to the use of competency pay. Use of competency pay is largely divergent between surveys such as 7.9% in organisations below 1,000 employees and 10.5% in organisations above 1,000 employees (CIPD 1997b), 22% (Industrial Society 1998b) and 32% (IRS 1999a). The author considered to state that “the rates of respondents that implemented competency pay were between about 10% and 30%. One of the reasons that differences in rates captured by the surveys may be the difference of type of competency pay included in the definitions in the surveys” (28p). This is because the author recognised that several definitions in both competency and competency pay are provided to practitioners. Further, definitions of competency and methods to use competency pay differ among the case study firms. In addition, the case studies found whether competency pay is used or not is not very consistent within each case study firm (this will be indicated in chapter 7). In this situation, the author believed the validity of figures captured by each survey is not very high. Therefore, capturing approximate figures generated by several surveys are appropriate to show the trends.

The author recognised that the Workplace Employee Relations Survey (WERS) has the highest validity (in both internal and external validities) in many areas such as its wide coverage of UK organisations, high response rate, multiple respondents in one

organisation (establishment) and data gathering method (interview for HR managers and worker representatives). Thus, the author sought to use the WERS data. However, unfortunately the 1998 WERS did not gather data in areas that this research seeks to use such as use of job evaluation, type of job evaluation used, type of pay structure, use of market pay, use of IPRP and use of competency pay. Hence, the author gave up use of the WERS data. As a result, the research encountered another problem. That is, the research cannot distinguish payment systems between industrial sectors in the private sector. Payment systems in the private sector may differ between industrial sectors or there may be variations between industrial sectors in private sector. For example, the WERS data show differences in the proportion of employees covered by collective pay bargaining between industrial sectors in the private sector. The highest proportion is 62% in electricity, gas and water supply, and the lowest proportion is 8% in hotel and restaurants, and real estates and business services. From the above differences, it is seen that not only pay bargaining structures but also other aspects of payment systems may differ between industrial sectors in the private sector. Although several surveys used in this thesis presented participants profiles concerning industrial sectors, there are not surveys that divide their data by industrial sector. This lack of division by industrial sectors may mask differences in payment system between industrial sectors. Japanese survey data presented in chapter 3 also suffered from the same problem, since there are no surveys that divide their findings by industrial sectors among the surveys used to indicate trends in Japanese payment systems.

2.2 Terminology

This section concerns terms used in the UK. Firstly, 'pay' and 'payment system' are defined.

Pay

"Payment for work, which can assume a number of different forms, includes a basic wage or salary, supplementary cash payments, such as shift pay and overtime pay, and benefits in kind" (Dictionary of Human Resource Management (Dictionary of HRM from here on) 2001:306p)¹⁸. Pay is also referred to as remuneration (Dictionary of HRM 2001, Armstrong 1999).

Payment system

¹⁸ In 'bibliography', this reference is reported in order of name of the authors 'Heery and Moon'.

“A payment system is a procedure for calculating employees’ pay, in the vast majority of cases by relating earning to some measure of work performed. There are many different forms of payment system but virtually all can be placed in either of two broad categories. Input-based payment systems link earnings to the time, experience, skills or competencies which employees bring to their work. Output-based payment systems base earnings on the product of work, measured either in operational terms (e.g. units of output, achievement of goals, customer satisfaction) or financially (e.g. sales, profitability, value-added). Examples of input-based payment systems include hourly rates of pay, annual salaries, overtime premiums, call-out payment, service-related increments, career grades which link pay increases to qualifications, and skill-based pay. Output-based payment systems include piecework, work-measured incentive schemes, appraisal-related pay, gain sharing, and employee share ownership” (Dictionary of HRM 2001:260p). In this definition, appraisal-related pay is categorised by output-based payment system. However, this thesis includes both output and input aspect of the person factor in relation with appraisal-related pay as will be discussed in ‘person factor’ section.

There are terms that express broader concepts relating to pay such as reward and compensation.

Reward

Rewards are benefits that employees receive in return for working on behalf of an employing organisation. Rewards can assume a number of different forms, though there are two main forms: extrinsic rewards, which take the form of cash payment and employee benefits and intrinsic reward such as job satisfaction, recognition, personal development, and the social status which may be attached to jobs (Dictionary of HRM 2001). Reward is a wider concept than pay and pay is included by in the concept of reward.

Compensation

This is a similar concept to reward, though there are variations of definitions of compensation among authors. Some only include extrinsic rewards such as pay and benefits and some include both intrinsic and extrinsic rewards. The term ‘compensation’ is used more often by American authors than by British authors. Hence, reward and compensation are wider concepts than pay that indicates a variety of returns that employees receive.

As this research focuses on base-pay, definition of base-pay is provided.

Base-pay

“Rate of pay for a job or grade in an organisation, to which can be added various supplements, benefits, bonuses and allowances. Base-pay is the core elements of remuneration that reflects, at least notionally, the market value of particular types of labour” (Dictionary of HRM 2001:19p).

2.3 Job factor

Characteristics and trends in base-pay in the UK are considered in relation to the job, market and person. The pay rate is basically attached to the job based on the relative value of the job determined by job analysis and job evaluation (Clegg 1988, Armstrong and Murlis 1998, Torrington and Hall 1994, 1998). Job-related pay has a long history in the UK. The history is traced back to describe how job-related pay was formed.

2.3.1 History of job-related pay

After industrialisation in the mid 18th century, the number of industrial workers increased in the UK. Piecework pay was then widespread. The origins of the piecework pay can actually be traced back to cotton manufacturers before industrialisation (Okayama 1990). From the end of the 18th century to the first half of the 19th century, trade unions emerged as worker’s representative bodies in order to seek improvements in working conditions, including pay. At first, trade unions were craft unions whose members had institutionally recognised skill certification in specific occupations acquired through apprenticeships. Skills recognised by the certification were applied to all firms that employed the occupational groups. The purpose of formation of craft unions was to protect the employment and working conditions of trade union members. General trade unions that do not require occupational skill certification for the members emerged at the end of the 19th century. Both craft unions and general unions that negotiated pay levels were formed on an occupational basis. Job-related pay was strengthened by this occupational-based trade union structure (Yuzawa 1996, Clegg 1988, Iwate 1991). From the end of the 19th century to the beginning of the 20th century, collective bargaining in some industries was established, as in engineering, iron and steel manufacture and textiles (Iwate 1991, Yuzawa 1996). Under collective bargaining, piecework rates were negotiated. Standard piecework rates were set for each job by each

local area in the textile, steel, printing and ship industries, and for each job on a factory basis in the engineering industry (Clegg 1988). As described, the job has continued to be the basis of pay.

Theoretical and ideological underpinning of job-related pay also evolved. Just after the start of the industrial revolution, Adam Smith claimed that fragmentation of jobs increases efficiency and productivity (Bratton and Gold 1999, Stirati 1994). Although Smith did not directly claim pay levels were differentiated by occupation or job, Smith's perspective on the job encouraged the division of Labour (Stirati 1994). Later, Hicks (1965) elaborated the claim by Smith and notion of marginal productivity of neo-classical economics to show that pay levels are balanced for each occupational group at the equilibrium wage. Scientific management proposed by Taylor (1911) further developed the principle of job fragmentation and standardisation, although many employers in the UK resisted scientific management, and a modified version of scientific management slowly and patchily spread in the UK (Clegg 1988, Littler 1982, Lane 1989, 1992, 1995).

2.3.2 Job evaluation

Job-related pay was further reinforced by job evaluation. Job evaluation is "a procedure for assessing the relative demands of jobs with a view to allocating jobs to positions within a pay structure" (Dictionary of HRM 2001:186p). Job evaluation methods are largely divided into non-analytical methods such as job ranking¹⁹ and job classification²⁰ in which whole job are examined and compared, without being analysed into their constituent parts or elements and analytical methods such point factor²¹ in which jobs are analysed by reference to one or more criteria, factors or elements (Armstrong and Murlis 1998).

¹⁹ "Job ranking compares whole jobs and does not attempts to assess separately different aspects of the jobs. It determines the position of jobs in a hierarchy by placing then in rank according to perceptions of their relative size" (Armstrong and Murlis 1998:88p).

²⁰ "Job classification compares whole jobs to a scale, in this case a grade definition. It is based on an initial decision on the number and characteristics of the grade into which the jobs will be placed. The grade definitions attempt to take into account discernible differences in skill, competence or responsibility. Jobs are allotted to grades by comparing the whole job descriptions with the grade definition" (Armstrong and Murlis 1998:89-90p).

²¹ Point factor is based on the breaking down of jobs into factors or key elements. Using numerical scales, points are allocated to a job under each factor heading according to the degree which it is present in the job. The separate factor scores are then added together to give a total score which represents job size (Armstrong and Murlis 1998).

(1) Theoretical underpinnings of job evaluation

The theoretical underpinning for job evaluation is found in market economic theory and equity theory (Adams 1965). Concerning market economic theory, as pay rates in the external labour market are gathered, pay levels based on job evaluation can reflect supply and demand in the labour market. This is consistent with the theory of market economics (Elliott 1991, Gomez-Mejia and Balkin 1992). Equity theory assumes that persons compare the ratio of input (all things that persons input to the job) and output (reward that persons receive from the job) between themselves and others. If the persons perceive that the ratio of themselves is equal to the ratio of others, they feel fairness or equity and they are motivated. Therefore, job evaluation attends to the sense of equity among employees by systematic and consistent judgment of jobs, while subjective judgment is inevitably included in the job evaluation process. Further, as the sense of equity is a subjective judgment by individuals, it is not necessarily achieved by job evaluation (Adams 1965, Armstrong and Baron 1995, Gomez-Mejia and Balkin 1992). Job evaluation also enables a link to be made between internal pay relationships and the external labour market by consideration of the market value of the job. In doing so, job evaluation can deal with external equity (Gomez-Mejia and Balkin 1992, Armstrong and Baron 1995).

(2) Historical background and recent trend of job evaluation

Formal job evaluation methods were developed in the US. Before the introduction of formal job evaluation, job levels linked to pay were judged by job title. Formal job evaluation started in government organisations in the US as the job classification method before the First World War. Whereas three major types of job evaluation -- job ranking, job classification and point factor -- developed for the private sector were in existence by 1926, job evaluation was not spread in the private sector in the 1920s. From the 1930s to the end of the Second World War, job evaluation methods spread in the private sector (Quaid 1993).

In the UK, there was little interest before the Second World War: only exceptional firms introduced job evaluation schemes, for instance ICI in 1935. After the Second World War, job evaluation schemes were slowly recognised (Arthurs 1998). In 1967, according

to a survey by the National Board of Prices and Incomes (cited in Clegg 1988), the proportion of respondents that operated job evaluation were 30% for managers, 27% for staff, 26% for blue-collar workers except craftsmen and 11% for craftsmen.

According to surveys, the population of UK organisations with job evaluation schemes is 53% in the private and public sector (Industrial Society 1996) and 68% in the private sector (IRS 1998). Despite criticism of job evaluation on the grounds that it is inherently bureaucratic, time consuming, incompatible with rapid change to the business environment and that it under-emphasises personal factors (IRS 1998, Lawler 1990), job evaluation is popular in UK organisations.

The Industrial Society survey (1996) also gathered data on types of job evaluation schemes yielding 66% for point factor, 18% for factor comparison²² and 15% for job classification. This result indicates that point factor job evaluation is the most widespread scheme in UK organisations. Surveys by Towers Perrin (1997, 2000) mostly for European-based MNCs (Multi-National Corporations) with over 1,000 employees provided different results. The 1997 survey found that 59% had point factor, 51% used market pricing and 36% job classification. The 2000 survey found that 46% used job ranking, 36% point factor and 29% job classification. As described, the rates of use of the point factor scheme are lower and the use of non-analytical job evaluation schemes such as job ranking and classification are higher in the two surveys by Towers Perrin than the survey by the Industrial Society. According to the results of the three surveys, it appears that non-analytical schemes are more widespread in large firms in the private sector than overall in UK organisations, including the public sector and SMEs (Small and Medium sized Enterprises). The two Towers Perrin surveys gathered the data from European-based MNCs, not only from UK-based private firms. Nonetheless, UK-based firms in the two surveys constituted 52% in the 1997 survey and 36% in the 1999 survey. As they are the highest proportion among various country origins of the respondents, characteristics of the UK respondents are reflected to a large extent.

(3) Problem of non-analytical job evaluation

Job evaluation, especially analytical job evaluation such as the point factor scheme is

²² “The factor comparison method is analytical, but compares jobs with jobs against a number of factors rather than using a scale” (Armstrong and Murlis 1998: 97p).

useful for the establishment of equal pay policy, since it compares each main factor in the construction of the job (Gomez-Mejia and Balkin 1992, Arthurs 1992, Armstrong and Baron 1995). Hence, how firms establish equal pay policies under non-analytical job evaluation should be questioned. Yet, according to IRS (2001a), establishment of equal pay policy by job evaluation is more difficult under the current situation where board banding is popular, and influence of IPRP (Individual Performance-Related Pay) and market pay for individual pay levels increased. How UK firms approach establishing equal pay policy will be analysed through case studies conducted during this research as a primary data gathering method. In the UK, equal pay often indicates equal pay between men and women (IRS 2000b, CIPD 2001a²³, Arthurs 1992). As differences in pay policy between men and women is excluded from this research²⁴, the analysis of how to establish equal pay policy in the case study firms is briefly analysed.

2.3.3 Pay structure

Pay structures are considered as a subcategory of the job factor, since the pay structure is created based on job characteristics in the UK. Firstly, the trend towards broadbanding of pay structures is considered in this subcategory. While there are various definitions of broadbanding (CIPD 1997a, Gilbert and Abosch 1996), the thesis adopts the simplest definition of “collapsing a number of salary grades into a small number of broad grades with wide ranges” (Milkovich and Newman 2002:654p). Although broadbanding emerged during the late 1980s, growth of broadbanding was slow in the US, and in the UK the growth was even slower. There were probably no more than a dozen organisations with a fully developed broadbanding pay structure in 1993 (CIPD 1997a, 1999). However broadbanding pay structures have been increasingly popular in recent years in both the UK and US (CIPD 1999, SHRM 1999). Table 2-1 and 2-2 show the results for pay bands in the CIPD survey (1999).

²³ The former IPD (Institute of Personnel and Development) changed its name to CIPD (Chartered Institute of Personnel and Development) in 2000. The thesis uses the name CIPD including before 2000.

²⁴ The reason for the exclusion is indicated in section 3.4.3 in chapter 3 and in section 5.3 in chapter 5.

Table 2-1: Number of bands obtained (CIPD 1999)

Number of grades/bands	Senior Executive	Managerial/Professional
3 or less	64%	40%
4-5	19%	34%
6-9	12%	18%
10 or more	4%	8%

Table 2-2: Range of band (CIPD 1999)

Normal grade (less than 25%)	24%
Broad grade (25—49%)	28%
Broader grade (50-79%)	30%
Broad band (more than 80%)	18%

* Percentages in tables 2-1 and 2-2 refer to the proportion of firms in the samples that use the indicated number and range of bands.

From the results, the survey concludes that broadbanding pay structures are now the most common in terms of number of bands. In terms of range of pay band, nearly half of the survey participants have a pay range of 50% or more. These pay ranges for pay bands used by the participants are different from the typical traditional pay structure whose pay ranges are less than 50% (CIPD 1999). The following reasons for broadbanding are suggested. The first is to increase the link to individual contribution, such as performance and skills, to pay. Second, as organisational structures have been flattened, the pay structure should align with career development rather than vertical promotion (CIPD 1997a, 1999, Gilbert and Abosch 1996).

The second issue concerning pay structure is job family pay structure. Job family is “a set of jobs based around common activities but conducted at different levels of the organisation. For instance, a finance and accounting job family could embrace junior finance officer, senior accountants, and the finance director of enterprise” (Dictionary of HRM 2002:187p). According to the survey by CIPD (1999), use of job family pay structure is small as 16% of the responding organisation used the job family pay structure.

2.4 Market factor

2.4.1 Concepts of market pay

Market rates are considered for the determination of pay levels in terms of pay grades or pay bands, and/or job families identified through job evaluation. Market rates of benchmark jobs and/or common jobs in the labour market are obtained through data such as general national and regional published surveys, sector surveys, occupational surveys, management consultants' surveys and job advertisements (Armstrong and Baron 1995). This practice is consistent with the concept of a competitive model of labour market adjustment presented by market economic theory. That is, the firm must identify prevailing pay levels for each of its jobs in order to recruit and retain a qualified workforce (Elliott 1991). Another purpose of this practice is to achieve external equity (Taylor 2000, Gomez-Mejia and Balkin 1992).

2.4.2 Historical background and recent trends of market pay

Historically, pay was not negotiated within individual organisations before the First World War. The pay standard of the piecework rate was negotiated at the regional level between industrial employer organisations and occupational trade unions. Organisation-based pay structure started after the First World War, when line managers within the organisations started to be involved in decisions regarding recruitment, selection and dismissal, and hence started to be involved in decisions relating to pay such as piecework pay and profit sharing. Therefore, the market rate for jobs directly determined individual pay levels before the First World War. After the First World War, individual organisations have gradually evolved distinctive pay structures (Clegg 1988). Internal relativity of jobs within organisations became important along with the expansion of organisations, but market rates have continuously been considered for individual pay determination.

Market pay is used in 45.6% of private sector firms (IRS 2001a). The CIPD survey (2002) (public and private sectors) notes the use of market pay as follows: 50.1% for senior-managers, 50.9% for middle-managers, 46.5% for non-manual non-management, and 37.5% for manual non-management. The 1997 Towers Perrin survey asked which factors influenced pay increases. 72% answered that competitive market position

influenced pay increases. Other elements relating market rates gathered by the survey are external market rates of increase (55%) and external rate of inflation (42%). In the 2000 Towers Perrin survey, 25% answered that wholly market driven pay with no internal job evaluation.

2.5 Person factor

2.5.1 Classification of pay relating to person factor

With regard to person factor, two fundamental criteria distinguish payment systems; time and a broadly defined notion of performance²⁵ (Milkovich and Newman 1999, 2002, Lynch 2000, Mathis and Jackson 1997). Reward systems are exchange mechanisms; employees offer skills, experience, knowledge, effort and time in exchange for money and other benefits. Time is an important component of that exchange (Lynch 2000, Mathis and Jackson 1997). Time-based pay is a payment system based on a predetermined rate of pay such as hourly pay, daily pay, monthly pay and annual pay. An example is when an hourly pay rate is set for a job and the amount of payment is determined by number of working hours (Mathis and Jackson 1997, Kessler 2001). In the job-based system, the job is used as the standard for a predetermined rate of pay for predetermined time units, instead of the person factor. For base-pay it is considered that the pay rate is determined by the job often with little relationship to individual performance (Milkovich and Newman 1999, 2002). However, the thesis discusses performance pay under the title of base-pay. This is because some types of performance pay such as merit pay and IPRP are used for pay progression of base-pay.

There are a variety of performance pay systems. Kessler (1994, 1995, 2000, 2001) comments that they vary across three dimensions, as follows:

- ① Unit of performance being assessed -- group and individual.
- ② Type of performance being measured -- inputs and outputs.
- ③ Link between performance and pay -- relatively fixed relationships and less

²⁵ As will be discussed in latter part of this chapter, this thesis uses term 'output performance' for output aspect of the person factor, 'input performance' for input aspect of the person factor such as skill, knowledge and behaviour, and 'contribution' that includes both output and input aspects of the person factor, because this thesis considers input-related pay such as competency pay. But term 'performance' is used in this part to express both input and output aspects of the person factor.

mechanistic links between pay and individual performance.

The classification of Kessler (2001) is indicated in table 2-3.

Table 2-3: Performance pay: linking type of performance with unit of performance

	Unit of performance	
Types of performance	Individual	Collective
Output	Piecework, Commission Individual bonus Individual performance-related pay,	Measured day work, Team pay Profit-sharing, Gain-sharing
Input	Skill-based pay, Merit pay Competence pay	Employee share ownership schemes

2.5.2 History and trends of pay relating to individual performance

Performance pay systems such as piecework and measured day work were popular for blue-collar workers. However, for blue-collar workers this type of pay has been decreasing. According to the New Earnings Survey, 49% of male blue-collar workers and 35% of female blue-collar workers received such performance pays in 1983 (cited in Armstrong 1996), but only 22% of blue-collar workers were covered by such schemes in 1999 (Office for National Statistics 1999). On the other hand, performance pay for white-collar workers, especially IPRP (Individual Performance-Related Pay) that relates assessment of individual performance to pay, has grown in importance (Kessler 1995, 2000, 2001, CIPD 2001b, Armstrong 1996, IRS 2001a).

Merit pay, which relates assessment of performance to base-pay, has also existed for a long time. Although Kessler categorises merit pay as an input performance scheme (table 2-3), other authors use the term 'merit pay' to refer to the pay increases of an employee as determined through assessment, which does not necessarily indicate only input as the subject of the assessment (Henneman 1992, IRS 2001a, Marsden and Richardson 1994, CIPD 1997b). Thus, the distinction between merit pay and IPRP is often not clear.

Merit pay was introduced in the 1920s or 1930s. At first, merit appraisal tended to be subjective and assessed traits or personality (Devries et al.1981, Armstrong and Baron 1998, Henderson 1984). Since the 1950s, development of appraisal technique has taken

place, such as the application of critical-incident techniques (Flanagan 1954) and the introduction of behaviourally anchored rating scales and behavioural observation scales (Henderson 1984, Latham and Wexley 1981). In the 1960s, MBO (Management By Objective) proposed by Drucker (1955) was often linked to appraisals (Devries et al. 1981, Armstrong and Baron 1998). However MBO was criticised as it often became a top down affair with little dialogue and it overemphasised quantifiable objectives (Fowler 1990, Armstrong and Baron 1998).

Instead of MBO, performance management has gradually become popular in the UK. Armstrong and Baron (1998) point out that performance management in the current context was first proposed by Beer and Ruh (1976). Performance management gradually spread in the US in the 1980s and was introduced to the UK in the late 1980s. Fowler (1990), Sparrow and Hiltrop (1994) and Bach (2000) discuss differences between performance management and MBO. For example, Fowler (1990) points out differences in characteristics between MBO and performance management such as the packaged system applied to managers and emphasis on quantified performance measures as characteristics of MBO, and tailor-made system applied to all staff and inclusion of qualitative performance indicators as characteristics of performance management. However, it should be noted that the differences are at the normative level; whether or not the two systems are really different is another issue. Also application of MBO and performance management varies among organisations (Fowler 1990, Fletcher and Williams 1992, Bach 2000).

Performance management is widespread in UK firms. 66% of firms in a survey by the CIPD (1998) implemented a formal performance management system. The main purposes of performance management found by the survey were 85% (objective setting and review), 83% (annual appraisal) and 68% (personal development). A survey by the Industrial Society (1998) found that the main purposes were 73% (training planning), 68% (individual motivation) and 57% (employee involvement). The two surveys suggest that performance appraisal relating to objectives set and development through appraisal are the two main purposes of performance management. With the spread of performance management, the term 'performance review' is often used instead of 'appraisal'.

2.5.3 Individual performance-related pay

(1) Trends of individual performance-related pay

Since there is no clear distinction between merit pay and IPRP, this thesis uses the term 'IPRP' to indicate base-pay increase relating to individual performance, because IPRP has been the focus of attention since the 1980s (Storey and Sisson 1993, Strebler and Bevan 2000, Sparrow and Hiltrop 1994). The following reasons for the introduction of IPRP have been presented (Bredwell and Holden 2001, Armstrong and Murlis 1998, Kessler and Purcell 1992, Torrington and Hall 1994, 1998).

- Increasing sense of equity among employees due to the link between individual performance and pay; by doing so, facilitating recruitment, retention and motivation
- Facilitating a performance culture
- Focusing on the individualistic relationship between employer and employees (making direct relationship not through collective entities such as trade unions)
- Increasing the responsibility of line managers
- Greater financial control and value for money

There are many surveys on the introduction of IPRP. In different surveys, use of IPRP has been reported as 60.5% (IRS 2001a), 60% (Gee Publication 1998) and 64% (CBI and William. M. Mercer survey 2000 cited in CIPD 2001). The data sources of the three surveys are firms in the private sector. IPRP may be more widespread in the private sector than the public sector. In one survey (CIPD 1997b), respondents in the private sector operated IPRP with a higher rate (43.6%) than respondents in the public sector (36.6%). Organisational size can influence the introduction of IPRP. The survey divides the results by organisational size and employee categories (management and non-management). Among respondents with over 1,000 employees, 49% operated IPRP for management and 27% for non-management. Among the respondents with below 1,000 employees, 35% operated IPRP for management and 24% for non-management (the rates include the private and public sectors). Hence, large firms in the private sector appear to use IPRP more than the public sector and SMEs, although this cannot be concluded using only one survey. Regarding types of employee, IPRP is mainly targeted at white-collar workers. Brown and Armstrong (1999) reviewed eight surveys on IPRP and found between 7% and 15% of organisations had applied individual, appraisal-based performance pay to their blue-collar workers.

(2) Theoretical underpinnings and problems of individual performance-related pay

The theoretical underpinning for IPRP can be expectancy theory (Vroom 1964, Porter and Lawler 1968) which predicts that high effort or motivation exists when an employee perceives a link between effort and performance, and performance leads to a positive outcome (reward). Agency theory also supports making explicit relationships between performance and pay. Agency theory assumes that principals (owners such as shareholders) must align the interests of the agents (employees including managers) in order that the agents act in accordance with interests of the principals, since agents do not necessarily act according to interests of principals due to divergent interests. Whereas agency theory is often applied to making an explicit link between organisational performance and executive pay, the same assumption can be applied to payment systems for the individual performance of employees (Gerhart 2000, Bloom and Milkovich 1998, Wiseman et al. 2000, Welbourne and Balkin 1995).

The increased interest in IPRP led researchers to examine the operation of the schemes (Kessler and Purcell 1992, Procter et al. 1993, Marsden and Richardson 1994, Randle 1997, Lewis 1998, Cully and Marginson 1995, Geary 1992). Researchers found problems in the operation of IPRP. The problems pointed out are largely divided into two areas; problems of assessment and problems of links with pay.

Problems relating to assessment are mainly concerned with notions of equity or fairness, in particular procedural justice (which refers to perceptions about the organisational procedures used to make outcome decisions) (Kanter 1992, Folger and Cropanzano 1998). Researchers found that perceptions of fairness or equity in performance appraisal had been enhanced by better procedures. For instance, procedural justice -- which includes disclosure of appraisal criteria, feedback for appraisees and self appraisal -- increase the motivation, organisational commitment and trust of managers (Folger and Konovsky 1989, Folger and Cropanzano 1998, Greenberg 1986). Brockner and Wisenfeld (1996) reviewed 45 studies of distributive and procedural justice and concluded that if persons feel distribution justice, they are unlikely to focus on procedural justice. Distributive justice refers "the perceived fairness of the amounts of compensation employees receive" (Folger and Konovsky 1989:115p). But if persons lose their sense of distribution justice, they are more likely to focus on procedural

justice, and if they do not feel equity in both distributive and procedural justice, their motivation and performance decrease. Researchers on IPRP also found problems related to goal setting. Goal setting theory (Locke 1968, Latham and Locke 1979, Batrol and Locke 2000) predicts that motivation and performance are higher when individuals are set specific goals, and when the goals are difficult but achievable and accepted by the individuals. Problems pointed out by researchers of IPRP may be related to weak goal acceptance of employees.

In order that the theoretical assumptions of expectancy theory and agency theory described above function, high performance must be related to high levels of reward. However, researchers have found that the influence of performance assessment on pay is not high (Cully and Marginson 1995, Richardson and Marsden 1994). This leads us to the second problem; resource limitations on IPRP. Employees may take high ratings in the appraisals and expect a high pay increase, but they are often disappointed by low pay increases. Regarding resource limitations of IPRP, A CIPD (1997b) survey found that average amounts of IPRP as a percentage of base-pay among respondents were 1-3% (37%) and 4-6% (32%). As indicated, the proportion of IPRP is not large. As discussed, research has revealed many problems with IPRP. So the question is, why do managements continue to utilise such incentive schemes?

(3) Management view point for individual performance-related pay

We now turn the focus of the discussion from the perspective of employees to the perspectives of managers. Kessler (2000) argues that early works on IPRP mainly focused on perceptions of employees that problems arose from the motivational impact on employees. But there are other purposes for the introduction of IPRP. If managements perceive that other purposes are achieved, they may feel that the purposes of IPRP are achieved to some degree. In fact, the CIPD survey (1997b) revealed positive views of managements towards IPRP. 80% answered as improvement of employee performance and 72% answered as improvement of delivering a clear message about the importance of organisational performance among respondents in the private sector. Opposite views towards IPRP are demonstrated by statistical analysis of the 1988 WERS (Workplace Employee Relations Survey) by Guest et al. (2000). Guest et al. (2000) found that employees reacted consistently negatively and managements reacted positively with increased productivity by IPRP. According to these results,

managements do not feel the negative effects of IPRP.

The views expressed may help explain the spread of IPRP despite its perceived difficulties. However, surveys (CIPD 1997b, Towers Perrin survey 1997) have found that management perceived problems of IPRP in the followings areas;

- IPRP increases too small to act as a motivator
- Inaccuracy of judgment by line managers
- Favoritism of line managers
- Line managers are inadequately trained

These perceptions indicate that managements have identified the difficulties pointed out by researchers in IPRP. In fact, according to the CIPD survey, the majority of respondents planned to change their IPRP schemes in areas such as 60% (performance management system), 58% (bonus or incentive plans), and 50% (pay and grading structure). However, 5% of respondents in the private sector had plans to abolish IPRP for managers and 4% for non-managers. Most firms in the private sector had no intention of abandoning IPRP.

2.5.3 Competency pay

Skill-based pay and competency pay are discussed as input performance schemes. Competency pay is given special attention, since competency pay was introduced only in the 1990s and has gradually diffused in recent years (IRS 1999a, 2001b, 2002, Sparrow 1996, IDS 1997, 2000). Skill-based pay takes the form of rewards related to the employee's ability to apply a wider range or a higher level of skills to different jobs or tasks. Skill-based pay was originally applied mainly to operators in manufacturing firms. However, it has been extended to technicians and workers in retailing, distribution, catering and other service industries (Armstrong 1996, Schuster and Zingheim 1992, Lawler 1990).

(1) Origin of competency approach

There are two origins of competency approaches in the UK; the US version and the UK version (Miller et al. 2001, Armstrong and Baron 1998, Woodruffe 1992). The US version of the competency approach can be traced to the work of David C. McClelland

who initiated the development of job competence assessment methods (McClelland 1973, 1993, Boyatzis 1982). The US version of the competency approach defines competency as underlying factors of personal characteristics. The purpose of the competency approach is to find personal characteristics in particular, specifying behaviours associated with high performance (McClelland 1973, Boyatzis 1982, Spencer and Spencer 1993). The UK approach is based on standards of NVQ/SVQ (National/Scottish Vocational Qualification) developed at the initiation of the UK government since the late 1980s (Hyland 1994, Cotton and Robbins 1996, Marsden 1994). The approach used is factor analysis for competencies required by specific job categories. The UK approach focuses on behaviours, skills and knowledge required by jobs. The US approach focuses on behaviours and personal characteristics underlying behaviours. Because of these differences the US and UK versions are often called the soft version and the hard version respectively (Miller et. al 2001, Armstrong and Baron 1998, Woodruffe 1992, Adams 1995, 1997).

In order to distinguish these differences, some authors use term 'competency' for the US version and term 'competence' for the UK version (Woodruffe 1992, Miller et. al 2001, Armstrong and Baron 1998,). However, as term 'competence' is used in job competence assessment by McClelland (1973, 1993) considered as the origin of the US version of competency, there are no clear distinction of meaning of the terms of competency and competence. There are some differences between the two versions as indicated, but the author hardly recognises differences between them in level of behavioural indicators²⁶. This thesis uses terms 'competency' and 'competency pay', while Kessler's classification indicated in table 2-3 uses 'competence pay'. Reason for it is that majority of literature use 'competency' or 'competency pay' in the author's knowledge. Terms 'competency-based pay' and 'competency-related pay' are also used.

(2) Trends of competency pay

Scholars and practitioners in the UK started to pay attention to the competency approach in the mid or late 1980s. Now the competency approach has spread in UK organisations. In a survey by IRS (2002) (private and public sectors), 64 % of

²⁶ Competency profiles consist of competency headlines and behavioural indicators in each competency headline.

respondents implemented the competency approach²⁷.

In the early days, competencies were mainly used for recruitment, career promotion and development. The link of the competency approach to appraisal and pay has been gradually considered since the beginning of the 1990s (Torrington and Blandamer 1992, Sparrow 1996, Brown and Armstrong 1999).

There are various types of competency pay. Brown and Armstrong (1999) broadly categorise competency pay into two types; a job-focused system that uses competencies as the criteria, wholly or partly, to evaluate jobs; and a person-focused system that links pay levels and increases to the levels of competencies attained by individuals. According to surveys such as IRS (1999a, 2002), CIPD (1997b) and the Industrial Society (1998b) (respondents of the three surveys are private and public sector firms), the rates of respondents that implemented competency pay were between about 10 % and 30 %. One of reasons for differences in rates captured by the surveys may be differences in types of competency pay included in the definitions in the surveys²⁸. However, the rate at which the respondents use competency pay is not high compared with the spread of the competency approach captured by the IRS survey indicated above. According to a survey by IRS (1999a), the main reason for not implementing competency pay is “making relationship between competencies and pay is too early” (53%) (1999:25p). Regarding sector and organisation size, the private sector and large organisations operated competency pay with higher rates than the public sector and SMEs. This tendency is the same as for IPRP.

(3) Reasons for introduction of competency pay

One of the reasons for the introduction of competency pay is to overcome or complement weaknesses of output-related IPRP. The reasons are as follows. Firstly, IPRP encourages only what is achieved, but how objectives are achieved is also important to ensure high performance in the long term. Secondly, IPRP encourages employees to achieve certain objectives set at the expense of other aspects of jobs

²⁷ In this survey, competency approach includes making relationship between NVQ/SVQ and job grade within the organisation.

²⁸ Surveys use narrower definition for competency pay such as “pay linked to skill acquisition or behavioural development” (CIPD 1997b:1p) tend to find low rate and surveys use broader definition including both the job-focused and the person-focused systems tend to find higher rate for use of competency pay (IRS 1999a, 2002).

(Torrington and Blandamer 1992, Kessler 2000, Brown and Armstrong 1999). There are other reasons for the introduction of competency pay. First, flatter organisational structures provide less opportunity for traditional development through promotion. Second, there is a need for increased flexibility in work requiring employees to develop a wider range of skills over time (IDS 1997, Armstrong and Brown 1998, Brown and Armstrong 1999).

(4) Relationship between performance management and competency approach

After the spread of the competency approach, competencies are often linked to performance management. For example, in the IRS (2002) survey, 82% (among respondents using competency approach)²⁹ identified performance management as one area where competencies were used. Linking the competency approach with performance management might have changed the concept of 'performance' in performance management. In articles on performance management, the meaning of 'performance' almost equated to output performance or result until the mid 1990s (Fowler 1990, Fletcher and Williams 1992, Bevan and Thompson 1991, Storey and Sisson 1993, Sparrow and Hiltrop 1994). However, since 'performance' started to include competencies, it has often included the process as well as the result. Further, competency can include skill and knowledge (Woodruffe 1992, Brown and Armstrong 1999). Consequently, the concept of performance became broader to include both output (result) and input (knowledge, skills and behaviours³⁰) (Williams 1998, Armstrong and Baron 1998, Brown and Armstrong 1999). This thesis uses the term 'output performance' to express results or output aspects of performance and the term 'input performance' to express input aspects of performance such as knowledge, skills and behaviours, including competencies. Further, the term 'contribution' is used to express both output performance and input performance.

2.6 Summary

The payment system in the UK consists of job, market and person factors. The job is the basis of the pay structure and individual pay levels. Market rates for jobs are considered in the decision relating to individual pay levels and person factors such as time and

²⁹ 52% used competency approach in performance management among all respondents in the survey.

³⁰ Behaviours can be also viewed as the middle position between input and output.

performance (or contribution) also influences individual pay levels. Among various performance pay schemes (or contribution pay schemes), less mechanistic types of performance pay (or contribution pay) such as merit pay and IPRP have been increasingly applied to white-collar workers. The theoretical underpinnings of the UK payment system described in this chapter are largely divided by economic theories such as market economic theory and agency theory, and psychological theories such as equity theory, expectancy theory and goal setting theory. The payment systems and the theoretical framework of the UK system are very different from those of the Japanese system discussed in the next chapter. The differences may be a reflection of different employment practices and the historical backgrounds of the two countries.

Chapter 3: Characteristics and trends of payment systems in Japan and comparison of pay between Japan and the UK

3.1 Structure of this chapter

This chapter consists of eight sections including this section. Section 3.2 introduces terminology and concepts used in Japan concerning payment systems. Section 3.3 discusses the main characteristics of payment systems in Japan. The discussion reveals that the major characteristic of Japanese payment systems is the person-based system. Job and market factors do not directly relate to individual pay levels. The discussion in this section includes characteristics of Japanese payment systems in many other aspects such as type of *kihonkyu chingin taikei* (elements of base-pay), pay structure and appraisal.

Section 3.4 compares pay between Japan and the UK. The first part of section 3.4 identifies the basic characteristics of the two payment systems: a person-, stock- and organisation-based payment system in Japan and a job-, flow- and market-based payment system in the UK. The latter part of section 3.4 compares pay profiles between Japan and the UK from various angles. The comparison of pay profiles reveals that pay profiles in Japan are more seniority-related in terms of age and years of service than pay profiles in the UK.

Section 3.5 uses economic theories to discuss the rationality of seniority pay within the context of the spread of long term employment. Economic theories can explain the rationality of seniority pay under long service to some degree, but they cannot explain why years of service differ among advanced countries. An understanding of historical events in a society is needed in order to understand the reason why particular types of employment practices have spread in each country. Accordingly, section 3.6 turns the discussion to the historical evolution of long term employment, seniority pay and the person-based HRM system in Japan, in order to explain how and why particular types of employment and payment system have been established.

Section 3.7 discusses recent trends in payment systems in Japan. Although the person-, stock- and organisation-based payment system is identified as the basic characteristics of the Japanese payment system, these characteristics are currently changing. Section

3.7 focuses on the change in relative emphasis among person factors, and the introduction of job factor as the recent trends. Further, recent concerns with market pay are mentioned.

3.2 Terminology and concepts

This section focuses on elements of pay in Japan, and terminology and concepts relating to payment systems used in Japan. Firstly, two terms that are the closest equivalent to 'pay' in English are introduced.

Chingin

Article 11 in *Roudou Kijunhou* (Employment Standard Law) defines *chingin* as employers' pay to their employees as the price of the employees' work (*Jinji Yougo Jiten* (Dictionary of HRM from here after) 2001)³¹.

Kyuyo

Kyuyo is a similar concept to *chingin*. However, the concept of *kyuyo* is broader than the concept of *chingin*. For instance, benefits provided by employers by their voluntary action such as celebration money or condolence money are included in *kyuyo*, but *chingin* includes only financial benefits determined by formal employment regulations or collective bargaining (Dictionary of HRM 2001, Sasajima 2001a).

The thesis refers to *chingin* as 'pay' in English.

Next is the closest equivalent to 'payment system' in English. Two words corresponding to payment system are *chingin taikei* and *chingin seido*. *Chingin taikei* focuses on elements that determine pay; *chingin seido* focuses on rules on how to distribute total personnel costs among individuals (Dictionary of HRM 2001). Regarding *chingin taikei* for example, a firm decides on the elements of monthly pay which are base-pay, manager allowance, and dependent allowance. The proportion for each element is; 70% for base-pay, 20% for manager allowance, and 10% for dependent allowance. Furthermore, the firm divides elements of the base-pay into age-related pay and grade-related pay, and sets each element as 60% for age-related pay and 40% for grade-related pay within the base-pay. The above elements and proportion of each element are *chingin taikei*. Regarding *chingin seido* for example, decision areas such as percentage of monthly pay which is related to appraisal ratings, how appraisal ratings

³¹ In 'Bibliography', this reference is reported in order of the author's name 'Japan Institute of Labour'.

are decided and the relationship between ratings and pay increase/decrease rates are included *chingin seido*. The thesis regards *chingin seido* as being the corresponding term for payment system. *Chingin taikei* is referred to as ‘elements of pay’.

Authors provide examples of elements of pay (*chingin taikei*). Here two examples are presented – one is by Sasajima (2001a) and the other is by Ikekawa (1992).

Example of *chingin taikei* (elements of pay) by Sasajima (2001a).

1) *Genkin chingin* = pay in cash

1.1) *Teiki chingin* = Regular pay (monthly pay)

1.1.1) *Shoteinai chingin* which consists of *kihonkyu* and *shoteinai teate*

1.1.2) *Shoteigai chingin*

1.2) *Tokubetsu chingin* = special pay which consists of *shoyo* and other types of special pay

2) *Taishokukin* = money paid in the event of the employee quitting or retiring.

2.1) *Taishoku ichijikin* = money paid as a lump-sum when an employee retires or quits

2.2) *Taishoku nenkin* = company (or occupational) pension

The meanings of some components in the elements of pay are indicated below.

Shoteinai chingin

Pay is paid regularly (usually monthly) with fixed amounts of money for work within regular working time. According to a definition by survey of the MWHL, *shoteinai chingin* includes *kihonkyu* (base-pay) and regular *teates* (allowances) such as family allowance and manager allowance (Dictionary of HRM 2001).

Shoteigai chingin

Pay is paid in non-fixed amounts of money. Amounts of *shoteigai chingin* vary according to factors such as working time (e.g. overtime allowance and midnight duty allowance) and conditions or types of work (e.g. shift allowance and stand-by allowance) (Dictionary of HRM 2001).

Kihonkyu

This term corresponds to ‘base-pay’ in English. Base-pay is determined by age, academic background, experience, ability³², qualification, status and job. *Kihonkyu* is also known as *honkyu* (main pay). There are many types of *kihonkyu* with particular

³² Ability is used to refer to the Japanese word ‘*nouryoku*’ that constitutes to input performance such as skill, knowledge, behaviour and attitude of an employee as indicated in chapter 1.

characters such as *nenreikyu* (pay for age), *kinzokukyu* (pay for years of service), *gakurekikyu* (pay for academic background), *nouryokukyu* (pay for ability), *shikakukyu* (pay for qualifications), *shokumukyu* (pay for jobs), *shokunoukyu* (pay for job-related ability) and *sougouketteikyu* (pay determined by a comprehensive judgement in consideration of several elements) (Dictionary of HRM 2001).

Teate

This term corresponds to ‘allowance’ in English. The thesis refers to *teate* as allowance in English. *Teate* is paid as a supplement to base-pay. The rate of *teate* within *shoteinai chingin* or *kijunnai chingin* is usually between 10% and 20% (Koyanagi 1998, Sasajima 2001a).

(1) Types of *teate*

Types of *teate* and the areas covered by *teate* may be broader than those described as ‘allowances’ in the UK. Koyanagi (1998) lists seven types of *teate*, and Miyashita (1972) indicates four types of *teate*. Kawano (1990) divides *teate* into two main types. The classification by Kawano is shown.

1) *Kihonkyu chousei teate*

Payment and levels of *teate* are determined by each organisation. The purposes of this type of *teate* are to adjust pay levels to individual living costs that base-pay does not sufficiently cover, and to adjust pay levels to levels of job that are not sufficiently rewarded by base-pay. This type of *teate* is further divided into two types: *seikatsukyu teki teate* and *shigotokyu teki teate*.

1.1) *Seikatsukyu teki teate* (allowance for cost-of-living)

This is *teate* paid to take account of the family and life of individual workers where living costs are not sufficiently covered by base-pay. Examples include family allowance, house allowance and local allowance.

1.2) *Shigotokyu teki teate* (allowance for jobs)

This type of *teate* is further divided into two types:

Type 1: *Teate* paid to reward an employee where the level of the job and the level of ability required to perform the job are not sufficiently compensated by base-pay. Examples include manager allowance, title or job allowance, and special operation allowance.

Type 2: *Teate* paid to reward short term performance or the positive attitude of workers. Examples are performance allowance, no absence allowance and hard work allowance.

2) *Kihonchingin hojyu teate*

The payment of this type of *teate* is regulated by laws. Examples are overtime allowance, holiday attendance allowance and midnight duty allowance.

(2) Reasons for inclusion of many types of *teate*

Authors have discussed why Japanese pay includes many types of *teate* (Kawano 1990, Miyashita 1972, Koyanagi 1998, Sasajima 2001a). First, Base-pay covers all employees, although levels of base-pay differ among employees. However, each *teate* has its own purpose. For example, special duty allowance is paid only for workers engaging in special duty and what type of duty is 'special' is judged by employers. Therefore, employers can limit the type and number of employees covered by each *teate*. Second, *teate* is more flexible than base-pay. *Teate* can be reduced or cut, but it is more difficult to reduce base-pay once it has increased. Although in practice reduction or abolition of *teate* is difficult once it is introduced, *teate* is still more flexible than base-pay. Third, many *teates* are often excluded from the calculation of *shoyo* (biannual regular bonus), *taishokukin* (money paid related to quitting or retirement) and other financial rewards that are calculated based on base-pay (or base-pay plus some *teates* in *kijunnai chingin*). Each organisation can choose which *teates* are included or excluded from the calculation for each purpose.

Shoyo

(1) Concepts of *shoyo*

This term corresponds to cash based company wide bonus or profit sharing in English. *Shoyo* is also referred to as bonus in Japan. However, *shoyo* in Japan and bonus in the UK are qualitatively different, and the most significant difference between *shoyo* and bonus may be that *shoyo* is paid regardless of the business situation as discussed in reasons for payment of *shoyo* discussed in next paragraph. *Shoyo* is translated into English as 'biannual regular bonus', reflecting practices of *shoyo* which is paid regularly, biannually, regardless of the business situation. According to an interpretation by the MHLW, *shoyo* is paid regularly or irregularly according to *seika* (output performance) of workers and organisations. Amounts of money are not fixed in advance. *Shoyo* accounts for a large proportion of yearly income. About 30% of the yearly income is paid in the form of *shoyo* (Koyanagi 1998, Sasajima 2001a).

(2) Reasons for payment of *shoyo*

Various reasons for payment of *shoyo* are identified by authors (Kagiyama 1977, Sasajima 2001a, Koyanagi 1998). The first is the social custom hypothesis. Today, the payment of *shoyo* is almost an obligation for employers. The second is the incentive

hypothesis. *Shoyo* is an incentive to the efforts and contribution of employees. Before the end of the Second World War, *shoyo* was clearly an incentive. In that period, employers had much higher discretion about the selection of employees covered by *shoyo* and individual levels of *shoyo*. The third is the suspended payment hypothesis. Monthly pay is set at a lower level than the company can afford to pay, and employees are paid an additional payment as *shoyo* after profit levels are determined. As it is difficult to dismiss employees under lifetime employment practices, firms have difficulties in adjusting personnel costs by reducing head counts. Hence, *shoyo* is a useful mechanism for the adjustment of personnel costs. The fourth is the distribution of profit hypothesis. *Shoyo* is a profit sharing scheme. This hypothesis is related to the incentive hypothesis. The difference between them is that this position emphasises group contributions or achievement, and the incentive hypothesis emphasises individual contributions or achievement.

Taishokukin

The thesis refers to *taishokukin* as 'turnover money' in English. *Taishokukin* has two aspects. One is *taishoku ichijikin*, which is money paid as a lump-sum when employees quit firms or retire. The other is the money that employees receive after retirement as *kigyō nenkin* (company pension). *Taishokukin* in Japan was first introduced as *taishoku ichijikin*, and amounts of *taishoku ichijikin* are large (Sasajima 2001a, Kubo 2001, Yamazaki 1988). There are other characteristics of *taishokukin* in Japan. First, *taishokukin* is generally categorised as a pay or management tool, not as an employee benefit. The *taishokukin* system can be changed according to management policy. Recently this characteristic has been augmented by the introduction of the *taishokukin* system related to individual assessment. Second, amounts of the *taishokukin* are radically increased by years of service. The direct cause of this is that tax exemption money for *taishoku ichijikin* is increased according to years of service. This steep *taishokukin* curve with years of service has the same effect of seniority pay in preventing the shirking of workers.

Example of *chingin taikai* (elements of pay) by Ikekawa (1992)

1) *Getsurei chingin* = monthly pay

1.1) *Kijunnai chingin*

1.1.1) *Kihonkyū* = base-pay

1.1.2) *Koteiteki shoteate* = various fixed allowances

1.2) *Kijungai chingin*

2) *Sonota chingin* = other types of pay (biannual regular bonus, turnover money)

3) *Fukuri Kousei* = employee benefits

Kijunnai chingin

There is no formal definition in law of *kijunnai chingin*. In ordinary usage, *kijunnai chingin* often indicates certain areas within *shoteinai chingin*. The area of *kijunnai chingin* is determined by each purpose; such as elements in *shoteinai chingin*, on the basis of biannual regular bonus and turnover money, and elements of *shoteinai chingin*, as the subjects of collective bargaining. However, areas covered by *kijunnai chingin* are slightly different between firms (Dictionary on HRM 2001). Each firm can define its own area of *kijunnai chingin*.

For example, Company A defines base-pay, manager allowance and dependent allowance as areas or elements that constitute *kijunnai chingin*, and Company B defines base-pay as an area or element that constitute *kijunnai chingin* as the basis of the biannual regular bonus. Levels of the biannual regular bonus are usually announced in terms of how many months of *kijunnai chingin* are paid for standard employees (usually standard employees are 35 years old, high school graduate with wife and two children as dependents) when the biannual regular bonus is determined through collective bargaining. Thus, if base-pay levels and biannual regular bonus levels of Company A and Company B are the same for the standard employees, the number of months of *kijunnai chingin* paid as biannual regular bonus in Company B is higher than that in Company A, because *kijunnai chingin* in Company A includes base-pay, manager allowance and dependent allowance, but *kijunnai chingin* in Company B includes only base-pay. Further, usually what elements of *shoteinai chingin* constitute *kijunnai chingin* is not well articulated for the public. This means that the biannual regular bonus level in Company B looks higher than that in Company C. If Company A wants their biannual bonus to appear level low in the eyes of the public, then it will set its *kijunnai chingin* broader, because it thinks that the public may criticise its high biannual bonus level. Such a situation often happens in firms in industrial sectors where pay levels are relatively high (such as financial industry and general trading (*sogo shosha*) industries). As described, firms can utilize this characteristic of *kijunnai chingin* as each firm can define its own areas of *kijunnai chingin*.

Kijungai chingin

Kijungai chingin is part of monthly pay excluded from *kijunnai chingin*.

Fukuri kousei

This term corresponds with ‘employee benefit’ in English, and hence *fukuri kousei* is referred to as ‘employee benefit’ in this thesis. There are two types of employee benefit; employee benefit determined by laws named *houtei fukuri kousei* and employee benefit voluntarily determined by organizations named *houteigai fukuri kousei*. Employee benefits in Japan have two main characteristics. One is that types of employee benefit covering a wide range and high level of benefit, especially in large firms, are voluntarily determined. The government encourages employee benefit by provision of income tax exemption, because high employee benefit reduces social security costs. The other is that employers use employee benefit as an employee management tool in order to increase employees’ loyalty and sense of belonging (Fujita and Kojima 1997, Fujita 1997, Tsuda 1987). For example, most large firms provide company houses or dormitories at very cheap prices. The main purpose of this provision is to increase employees’ loyalty and sense of belonging. Employees tend to increase their loyalty to their firms because of their appreciation of the provision and they tend to increase their sense of belongingness, since employees’ neighbors are other employees and employees’ families. Employees and their families tend to increase their sense of belonging due to close relationship with other employees and their families.

In summary, elements of pay are; base-pay, allowance, biannual regular bonus, turnover money and employee benefit (employee benefit is sometimes excluded from elements of the pay). This thesis limits the research targets to base-pay as discussed in chapter 1. Although the thesis focuses on base-pay, information gathered through the research includes other elements of pay -- allowance, biannual regular bonus, turnover money and employee benefit -- in order to capture the whole picture of the payment system.

3.3 Characteristics of base-pay systems in Japan

Kihonkyu (base-pay) is the most influential and important element of pay. While for the UK payment system analysis of base-pay was divided by job, market and person factors, for the Japanese payment system analysis of base-pay is not divided by these three factors, since in many cases job and market factors do not directly constitute the

payment system. Instead, the reasons why the job and the market do not directly constitute the payment systems will be discussed. Surveys on HRM are generally divided by the private and public sectors in Japan. All surveys in Japan used in this thesis exclusively target the private sector. As the research targets large private sector firms, the thesis focuses on survey data about large firms as much as possible in the case of both Japan and the UK.

3.3.1 Elements of base-pay captured by surveys

One of the main characteristics of base-pay in Japan is that *kihonkyu chingin taikei* (elements of base-pay) is usually divided into two types; *tanitsugata chingin* and *heizongata chingin* (Ikekawa 1992, Kawano 1990, Mitani 1997). Classification of *tanitsugata chingin* and *heizongata chingin* in this thesis follows the definition used by *Syurou Jyoken Sougou Chousa* (The General Survey on Working Conditions)³³ conducted annually by MHLW. Definitions of the two types of pay by the survey are:

Tanitsugata chingin – Base-pay constructed from one form or type of pay which contains several elements to determine pay levels

Heizongata chingin – Base-pay made up from more than two forms or types of pay

Further, there are some types of pay within base-pay. The General Survey on Working Conditions distinguishes the following three types of pay within base-pay.

Shigotokyu – Pay related to job content or ability to perform job

Zokujinkyu – Pay related to personal characteristics such as age, years of service and academic background

Sougoukyu – Pay determined by a comprehensive judgement considering several elements such as job content, ability to perform job, age, years of service and academic background. Table 3-1 indicates the use of each type of ‘element of base-pay (*kihonkyu chingin taikei*)’ founded by the General Survey on Working Conditions (1996) for the respondents with more than 1,000 employees.

³³ General Survey on Working Conditions: the subject of the survey is firms in the private sector with more than 30 permanent employees. In the 2001 survey, the number of the subjects was 5,300. The response rate is not indicated in the survey, but the response rate is generally high. The former name of the survey was ‘*Chingin Roudou Jikan Seido tou Sougou Chousa*’ and the name was changed to the current name in 2001. The thesis uses the current name and includes the past surveys.

Table 3-1: Use of each type of *kihonkyu chingin taikei* (elements of base-pay) (%)

Type of <i>kihonkyu chingin taikei</i> (elements of base-pay)	Manager	Non-manager
<i>Tanitsugata chingin</i>	57.0%	37.3%
<i>Shigotokyu</i>	26.3%	7.5%
<i>Zokujinkyu</i>	0.8%	1.6%
<i>Sougoukyu</i>	29.9%	28.2%
<i>Heizongata chingin</i>	43.0 %	62.7%
<i>Shigotokyu + Zokujinkyu</i>	26.6%	39.8%
<i>Shigotokyu + Sougoukyu</i>	11.0%	12.5%
<i>Zokujinkyu + Sougoukyu</i>	3.7%	7.1%
<i>Shigotokyu + Zokujinkyu + Sougoukyu</i>	1.6%	3.3%

As indicated, *tanitsugata chingin* is more popular for managers and *heizongata chingin* is more popular for non-managers. The main reason for this difference is that *shigotokyu* has a larger proportion for managers (26.3%) than non-managers (7.5%) and *shigotokyu + zokujinkyu* has a larger proportion for non-managers (39.8%) than for managers (26.6%). In other words, *zokujinkyu* that accounts for personal characteristics is given more emphasis for non-managers.

Although *tanitsugata chingin* is operated, base-pay is often determined by consideration of several elements (*sougoukyu*). According to the General Survey on Working Conditions (MHLW 2001b), elements considered in base-pay among respondents with more than 1,000 employees were; *shokumu suikou nouryoku* (ability to perform job or job-related ability) receiving 84.9% for managers and 86.2% for non-managers, *gyouseki* or *seika* (output performance or result) receiving 78.1% for managers and 70.1% for non-managers, *zokujin teki youso* (personal characteristics) receiving 52.8% for managers and 82.4% for non-managers, and contents of jobs receiving 58.5% for managers and 53.0% for non-managers.

Elements of Japanese base-pay can be divided into two types. The first type is elements that construct independent units within base-pay and the second type is elements considered for determination of the base-pay level but which do not constitute independent units. In the UK, base-pay is the smallest unit and there are no independent units within base-pay. There are several elements considered for determination of base-pay, but they do not form independent units. There is an equivalent concept for the second type, but no equivalent concept for the first type in the UK payment system. For

example, assessed performance through appraisal is considered in individual pay reviews such as IPRP, but IPRP does not constitute an independent unit within base-pay.

3.3.2 Main characteristics of Japanese pay as person-related pay

(1) Characteristics of elements making up base-pay

The next consideration is the characteristics of each element making up base-pay. *Zokujin teki youso* (personal characteristics) and *Shokumu suikou nouryoku* (job-related ability) are the major factors in pay decisions as indicated above. Both factors concerns person factors. The difference between them is that people cannot change personal characteristics, but people can change job-related ability by their efforts. The main personal characteristics are age, years of service and academic background. Age and years of service cannot be changed by the effort of people, and people have difficulty to change their academic background after they have started their working life, although it is not impossible (Kusuda 1987, 2001, Kagiya 1989).

One of the reasons for seniority pay is to take into account personal characteristics in pay determination. Seniority consists of two aspects: age and years of services. In the Japanese case, years of service are almost proportional to age under spread of long term employment practices, where new employees are mostly new graduates (Tanaka 1988, Tsuda 1988). As indicated, job-related ability is the largest factor in pay decisions. Pay based on job-related ability is called *shokunoukyu* (job-related ability pay).

Under job-related ability pay, pay levels are determined according to the level of job-related ability of an employee, *not* the level of jobs that an employee is assigned to. Job-related ability pay is person-related pay, not job-related pay. Job-related pay is named *shokumukyu* in Japanese³⁴.

(2) Historical background and recent trends of person-related pay

Various surveys show that job-related ability pay is very important compared with job-related pay (Nikkeiren 2001, Sanno University 1999). For instance, in a survey by

³⁴ The category of *shigotokyū* in General Survey on Working Conditions indicated in table 3-1 includes both *shokunoukyū* (job-related ability pay) and *shokumukyu* (job-related pay).

the JPCSED (2000a), 72.9% of firms operated job-related ability pay for managers and 81.7% for non-managers, and 21.1% operated job-related pay for managers and 17.7% for non-managers. In a survey by the Institute of Labour Administration (2001b), among respondents with more than 3,000 employees, 68.5% used job-related ability pay and 12.8% used job-related pay, and among all respondents, 72.4% used job-related ability pay and 13.8% used job-related pay. Job-related ability pay is clearly dominant in Japan. But although usage of job-related pay is small, it does not necessarily mean that Japanese HRM does not consider job factors. In fact, Dore (1973) pointed out that job content was more widely documented in Japanese factories more than British factories. However, jobs are not simply directly connected to pay (Tanaka 1988).

Job-related abilities are usually measured based on *shokunou youken* (criteria relating to job-related abilities). As will be described in next section about *shokunou shikaku seido* (qualification system based on job-related ability), 'the criteria relating to job-related abilities' required by each *shokunou toukyu* (qualification grade based on job-related ability) are set. For example, in a survey of Institute of Labour Administration (1996), 68.5% of respondents had 'the criteria relating to job-related abilities'. However, 'the criteria relating to job-related abilities' tend to be general and abstract (Nikkeiren 2001). The main reason why 'the criteria relating to job-related abilities' tend to be general and abstract is that the same criteria are applied to all employees with the same qualification grade based on job-related abilities (*shokunou toukyu*) regardless of their job contents and job families in many cases. Thus, other criteria such as age and years of service are often used for judgment of job-related abilities. This causes seniority-related promotion and pay (Kurata 1993, Kusuda 1994, Hattori 2000). For example, in a survey by JPCSED (2001), 62.1% of respondents agreed "operation in *shokunou youken* (criteria relating to job-related abilities) is too seniority-related" as a problem of the criteria relating to job-related abilities (2001:37p).

Job-related pay was introduced after the end of the Second World War at the suggestion of Allied Army (also job analysis and job evaluation were introduced). During the 1950s and 1960s, some large firms implemented job-related pay. The rate of use of job-related pay reached a peak in the early or mid 1960s. 14.8% operated it in 1963 (Nikkeiren 1963 cited in Kagiya 1989). Job-related pay in that period was applied only to blue-collar workers in the manufacturing sector (Sasajima 2001a). But after the late 1960s job-related pay was gradually reduced. Instead of job-related pay, job-related

ability pay increased during the 1960s and 1970s. The use of job-related ability pay in the Nikkeiren surveys (cited in Kagiya 1989) was 28.0% in 1963, 38.0% in 1968 and 40.0% in 1970 (Oyamada et al. 1997, Kagiya 1989, Uchida 2001, Sasajima 2001a).

(3) Reasons for declining job-related pay

Many authors (Tanaka 1988, Kagiya 1989, Oyamada et al, 1997, Kusuda 2001, Sasajima 2001a, 2001b, Sekiguchi 1996, Uchida 2001) have suggested why job-related pay was not widespread in Japan, and some of the main reasons are pointed out here. First, job-related pay reduced flexibility of work. As Japanese firms introduced many new technologies from advanced countries in the 1950s and 1960s, job content or the way of doing jobs often changed. In these circumstances, the firms needed flexible labour deployment. Second, the rotation policy is one of the main HRM policies under long term employment. Job-related pay is not suited to the rotation policy. Third, pay was largely influenced by personal factors where job-related pay was used. Oyamada et al. (1997) maintain that Japanese firms were familiar with pay for person factors. Pay for age was especially widespread during and after the war. Uchida (2001) and Sekiguchi (1996) claim that pay levels were too low to implement pure job-related pay. If firms tried to decide pay levels according to the results of job analysis and job evaluation, since the mid pay level may be the minimum level for cost-of-living, pay levels in low level jobs would be below the minimum cost-of-living. In this situation, pay for cost-of-living related to age-related pay is therefore a suitable method. Fourth, pay for jobs in reaction to the external labour market was not established in Japan. Where there is little external labour market influence, firms have no external standard to compare their pay levels. In this situation, job analysis and job evaluation require high levels of rigor in order to establish agreements with employees. Japanese firms saw difficulties in establishing a high level of rigor in job analysis and job evaluation. Further, Japanese firms hardly recognized the need to realize a high level of rigor, since the proportion of job-related pay against total amounts of pay was not large, even though job-related pay was in operation. Job-related pay was not widespread in Japan due to a mixture of these reasons.

Relating to the fourth point, the lack of external market pay rates for jobs still continues in Japan. As many Japanese firms, especially large firms, exclusively utilise internal labour markets, they have little need for market pay.

(4) *Model chingin* under person-related pay

In Japan, large firms often make *model chingin* (model pay). The model pay refers pay levels of employees whose pay has been increased by the standard level in the payment systems operated in the firm. Model pay is calculated in relation to age, years of service and number of dependents divided by academic background and sex (Dictionary of HRM 2001). Model pay can be thought of as market pay within person-related pay. However, as model pay indicates standard pay levels for each age group in relations to some conditions, model pay cannot be used for individual pay determination. Model pay is used for HR function to capture the average pay level of each age group in internal and external labour markets. Therefore, the concept of model pay is different from the concept of market pay used in the UK.

3.3.3 *Shokunou shikaku seido*

(1) Recent trends of *shokunou shikaku seido*

Job-related ability pay is generally seen as pay based on *shokunou shikaku seido* (qualification system based on job-related ability) (Sasajima 2001a, Kagiya 1989, Hattori 2000). The qualification system is the most widespread system and constitutes the basis of the HRM system in Japan. According to *Koyou Kanri Chousa* (the Survey of Employment Management) by the MHLW (1999), 93.5% of respondents with more than 5,000 employees used the qualification system, 86.5% of respondents with between 1,000 and 4,999 employees used the qualification system and 72.7% of respondents with between 300 and 999 employees used the qualification system. *Shikaku* (qualification) is an internal qualification recognised only in each organisation. The qualification system is the system that divides employees into grades according to their job-related abilities. This grade is called *shokunou shikaku toukyu* (qualification grade based on job-related ability). Each employee is classified into a certain qualification grade in this system. The grade is loosely related to jobs and positions not directly linked (Oyamada et al. 1997, Kurata 1993, Hattori 2000, Sasajima 1997, 2001b).

There are four main types of relationship between job and qualification grade. A survey

by the Institute of Labour Administration (1996) found the rate for use of the four types to be as follows. 12.1% for 'one to one correspondence between job (or position) level and the grade level', 60.7% for 'correspondence between a certain extent of job level and a certain extent of the grade level', 34.3% for 'minimum requirement on the grade level is set corresponding to each job level', and 2.1% for 'no correspondence between job level and the grade level'. This result demonstrates characteristics of the relationship between the qualification grades and job levels, as the qualification grade is not directly linked to job levels.

(2) Methods to decide individual qualification grade

There are two main methods to decide individual qualification grades. One is evaluation of job-related ability of an employee based on *shokunou youken* (criteria relating to job-related abilities) set by each qualification grade. The evaluation is mainly conducted by appraisal by line managers. The concrete method widespread in Japanese firms is as follows. Appraisal ratings usually expressed by rating category such as S, A, B, C, D (S is the highest and D is the lowest categories) are translated into numbers such as S = 5, A = 4, B = 3, C = 2 and D = 1. The rating points expressed by number at each appraisal are added together. The resulting rating point is considered as each employee's own point for the grade promotion. For example, if employee A takes rating point 4 in the first appraisal after joining the firm and he/she takes rating point 3 in the next time, his/her own point is 7 (4 + 3). A criterion is set as a threshold limit for appraisal ratings for promotion of the qualification grade. For example, if 15 points is set as a criterion for promotion to qualification grade 2, the sum of the rating points must exceed 15 points in order for the employee to be promoted to qualification grade 2 (or to become a candidate for the grade promotion). A concrete example of the grade promotion system will be shown in section 6.4.5 in chapter 6, using one of the case study firms in Japan. Other evaluation methods such as pencil and paper tests, recommendation for grade promotion by line managers, and assignment to training course are also required for some steps of the grade promotion.

The other is years of service in one qualification grade. There are three types of conditions for grade promotion: minimum, standard and maximum. The theoretical assumption of setting the guideline for years of service for each qualification grade is that job-related ability should progress by work experience relating to years of service.

This assumption is enabled by including not only apparent ability but also potential ability. Including potential ability is a feature of the concept of the job-related ability in Japan (Kusuda 1987, 2001, Sasajima 1997, 2001a, 2001b, Hattori 2000). In a survey by the Institute of labour Administration (1996), 79.7% set guidelines for minimum years of service, 41.2 % set guidelines for standard years of service and 31.1% set guidelines for maximum years of service for all grades or some grades.

Criteria used for grade promotion are shown by two surveys. Nikkeiren (2001) found 96.9% for ratings of appraisal, 3.1% for promotion interview, 38.5% for pencil and paper test, 36.9% for age and years of service and JMA Management Centre (2000) found that the sum of appraisal rating points³⁵ was 84.2% for managers and 78.9% for non-managers, and recommendation by managers was 76.1% for managers and 63.6% for non-managers. These results also demonstrate that the job is not directly linked to grade promotion, and appraisal ratings are the most widespread factor as a criterion of grade promotion.

3.3.4 Pay structure

The corresponding concept in the Japanese payment system to the pay structure in the UK may be *chingin hyou* (pay table) which expresses a position of every pay level within an organisation. An example of a pay table was shown in table 3-2. The shape of the pay table differs from the popular pay structure in the UK with a 'box type' pay structure that each pay grade or band has maximum and minimum pay points. The pay table may be somewhat similar to the pay spine³⁶ in the UK. The definition of the pay table also differs from the pay structure in the UK, as *chingin hyou* (pay table) collates whole pay levels that exist in an organisation into one table. The table indicates how pay is determined by academic background, age, years of service, job content and job-related ability (Dictionary of HRM 2001). The difference may be a reflection of the different characteristics of the payment systems between the UK and Japan. A characteristic of the pay table is that there is practically no ceiling on pay levels in each grade. This is because if employees exceed maximum *gou*³⁷ within a pay grade, the

³⁵ "Sum of appraisal rating points" indicates practices described above.

³⁶ "Pay spines consist of a series of incremental points extending from the lowest to the highest paid job covered by the structure" (Armstrong and Murlis 1998:165p).

³⁷ *Gou* or *gouhou* is pay points in each grade (Dictionary of HRM 2001). *Gou* is the minimum unit of pay level.

maximum *gou* increases. Therefore, there is virtually no limit for the maximum pay level in each grade. In the pay table, there is no concept of pay range, since pay ranges change if employees exceed the maximum pay point (Sasajima 2001a, Koyanagi 1998, Kusuda 1994, 2001).

Table 3-2: Example of *chingin hyou* (pay table) (¥)

Gou	Toukyu (Qualification grade based on job-related abilities)					
	Toukyu 1	Toukyu 2	Toukyu 3	Toukyu 4	Toukyu 5	Toukyu 6
1	727,000	897,000	1,143,000	1,425,000	1,695,000	1,980,000
2	767,000	941,000	1,191,000	1,477,000	1,751,000	2,027,000
3	803,000	981,000	1,235,000	1,525,000	1,803,000	2,079,000
4	835,000	1,017,000	1,275,000	1,569,000	1,851,000	2,127,000
5	859,000	1,056,000	1,311,000	1,598,000	1,895,000	2,171,000
6	897,000	1,102,000	1,343,000	1,645,000	1,935,000	2,311,000
7	937,000	1,190,000	1,371,000	1,677,000	1,971,000	2,347,000
8	-	1,231,000	1,395,000	1,705,000	2,003,000	2,479,000
9	-	-	1,451,000	1,749,000	2,031,000	2,507,000
10	-	-	1,485,000	1,765,000	2,055,000	2,531,000
11	-	-	-	1,790,000	2,075,000	2,567,000

Source: Modified version by Sasajima (2001a)

3.3.5 Annual pay increase system

(1) Elements of annual pay increase

The annual pay increase system in Japan has two elements: *base-up* and *teiki shoukyu*.

Base-up

A part of the annual pay increase determined by inflation, market trends and the firms' ability to pay (Dictionary of HRM 2001). *Base-up* is a method by which the pay standards of organisations are increased. Where organisations have a pay table, the pay table is changed (level-up) by *base-up* (Sasajima 2001a).

Teiki shoukyu

This is the regular pay increase applied to all employees regardless of the financial situation of organisations and individual contribution (MHLW 1998a). However, the pay increase rate usually differs among employees according to factors such as age, years of service, academic background and assessment (Dictionary of HRM 2001). *Teiki*

shoukyu (regular pay increase) is the pay increase of individuals, not the pay increase across the organisation. Where organisations have a pay table, the *gou* or *gouhou* of individuals changes by *teiki shoukyu* (Sasajima 2001a).

Most large Japanese firms have a pay table. In a survey by the JPCSED (1996a), 89.5% had a pay table, and 96.0% with more than 5,000 employees had a pay table. In Japan, the pay level is usually expressed by *toukyu* (grade) and *gou* (pay points within one grade). For example, the pay level of Manager A is *toukyu* 6, *gou* 6, and the amount of his/her monthly base-pay is ¥2,311,000. *Base-up* is an increase in pay levels across the firm. When *base-up* occurs, the pay table changes. For example, a monthly base-pay level of *toukyu* 1 *gou* 1 is increased from ¥727,000 to ¥737,000 by *base-up*. The *teiki shoukyu* constitutes individual base-pay increases by increase of *toukyu* or *gou*. For example, Manager B is *toukyu* 6 *gou* 4, with a monthly base-pay of ¥2,127,000. After the *teiki shoukyu*, his/her *gou* increases from *gou* 4 to *gou* 7. As a result, his/her monthly base-pay increases to ¥2,347,000 (see table 3-2).

(2) Elements of *teiki shoukyu*

There are three main types of regular pay increase (the typology uses by JPCSED 1996a). The first is *jidou shoukyu* which is automatic pay increase by age and years of service. The second is *satei shoukyu*, which is pay increase determined through appraisal. *Satei shoukyu* is referred to as appraisal-related pay in English. The third is *shoukaku shoukyu* which is pay increase by promotion of qualification grade (*toukyu*). The automatic pay increase and appraisal-related pay increase are considered as the annual pay increases among the three types of regular pay increase. This is because pay increases associated with grade promotion do not occur annually. The JPCSED (1996a) survey asked what types of pay increase were included in the firms' own definitions of regular pay increase. 18.4% included only automatic pay increases, 44.5% included automatic pay increases and appraisal-related pay increases and 34.8% included all three types.

According to the results, it is considered that most respondents operated appraisal-related pay increases. A survey by the Institute of Labour Administration (2001a) gathered more direct evidence for the spread of appraisal-related pay increases. In the survey, the number of respondents replying 'total pay increase is determined by

the appraisal-related pay increase' was 26.2% for non-managers and 52.3% for managers, the 'total pay increase is determined by the automatic pay increase' was 9.8% for non-managers and 7.5% for managers, and the pay increase consists of the appraisal-related pay increase and the automatic pay increase' was 64.0% for non-managers and 40.2% for managers. These practices may lead many researchers to characterise pay in Japan as seniority-related, but not as pure seniority pay. Japanese firms consider both seniority and merit in pay determination (Koike 1993, 1994, 1999, Sasajima 1997, 2001a, 2001b, Oliver and Wilkinson 1992).

3.3.6 Appraisal

(1) Concepts of *jinji hyouka* and *jinji kouka*

The closest concept to appraisal in Japan is *jinji hyouka*. *Jinji hyouka* includes all types of employee assessment. *Jinji kouka* expresses a similar concept to *jinji hyouka* but it mainly deals with the judgment purpose of pay and grade reviews (Hayashi 1993, Kusuda 1987, Hattori 2000, Oyamada et al. 1997). The thesis uses the English word 'appraisal' as a translation of '*jinji kouka*' and 'evaluation' as a translation of '*jinji hyouka*' to distinguish the two terms. It is noted that although academics divide *jinji hyouka* and *jinji kouka*, the two terms are often not clearly divided in practice. Many firms use the two terms without strict division. *Jinji kouka* (appraisal) also contains various types of appraisals such as *nouryoku kouka* (ability appraisal), *gyouseki kouka* (performance or result appraisal) and *sougou kouka* (comprehensive appraisal by mixture of ability appraisal and performance appraisal) (Hayashi 1993, Hattori 2000, Kusuda 1987). Further, each type of appraisal generally corresponds to each purpose as will be described in recent trends of evaluation and appraisal captured by surveys. The main reason for the one to one correspondence is assumed to be that the rating of each appraisal directly links to each purpose. For instance, base-pay increases are directly linked to ratings of the comprehensive appraisal (Hayashi 1993, Hattori 2000, Kusuda 1987). Concrete examples will be provided in section 6.4.2 in chapter 6 using practices in one of the case study firms.

(2) Trends of *jinji hyouka* and *jinji kouka*

There are many types of evaluations operating in Japanese firms. In a survey by the

National Personnel Authority (1999), the number of types of evaluation operating in firms was 38.7% (one type) and 58.0% (more than two types). Among respondents with more than two types of evaluation, average frequencies of evaluation in a single year were 1.1 times for grade promotion, 1.1 times for base-pay increases, 2.0 times for biannual regular bonus and 1.4 times for development. As indicated, many firms have more than two types of evaluation and at least four types of evaluation are conducted more than once in a year. Concerning the use of each type of evaluation, a survey by the Nikkeiren (1998a) found that 94.5% used *jinji kouka* (appraisal) for pay and promotion, 75.2% used *jiko shinkoku* (self declaration on career aspiration) and 64.3% used *mensetsu seido* (career development interview). As described, in Japan, the type of evaluation is divided by each purpose. This practice is different from UK practices in which one appraisal or performance review includes many purposes.

In a survey by the Nikkeiren (2001), 52.3% operated ability appraisal for managers and 71.2% for non-managers, and 82.9% operated performance appraisal for managers and 81.1% for non-managers. Concerning the frequency of these appraisals in a year, 'once for ability appraisal and two times for performance appraisal in a year' was 79.3% for managers and 81.0% for non-managers. The survey also asked for the purpose of each type of appraisal. The results are as follows. The ability appraisal is used for grade promotion with 87.9% for managers and 88.6% for non-managers. The performance appraisal is used for biannual regular bonuses with 96.7% for managers and 92.2% for non-managers. The comprehensive appraisal is used for base-pay increase with 80.4% for managers and 88.9% for non-managers.

3.3.7 Section Summary

In the Japanese payment system, the person is the basis for determination of individual pay levels. Person factors are divided into personal characteristics such as age, years of service and academic background, and job-related ability. The job is loosely related to pay levels, not directly linked. Market pay for the job is not considered for decisions of individual pay levels mainly because of the spread of long term employment. Hence, only the person factor among the three factors identified as the basic factors that contributes to the construction of the payment system in Japan. Job and market factors do not directly contribute to the construction of the payment system in most cases. These characteristics of the Japanese payment system are very different from those of

the UK payment system described in chapter 2. Pay structure, annual pay increase and appraisal systems are also different from the UK system. Elements of base-pay also differ between Japan and the UK. Base-pay is the smallest unit in the UK, but base-pay is not necessarily the smallest unit in Japan. Base-pay in Japan is often made up by some forms of pay as independent units.

3.4 Comparison of pay between Japan and the UK

3.4.1 Comparison of payment systems between Japan and the UK

(1) Characteristics of payment systems in Japan and the UK

The research identified the job, the market and the person as the basic factors that determine individual pay levels and the construction of the payment system. Payment systems in Japan and the UK are analysed using these three factors, and three contrasting characteristics between the two types of payment systems are identified:

- ☐ Person-based system versus job-based system
- ☐ Organisation-based system versus market-based system
- ☐ Stock-based system versus flow-based system

Regarding the first contrasting characteristic, the UK system is characterised by the job-based system, the Japanese system is characterised by the person-based system. In the UK system, individual pay levels are predominantly based on the value of the jobs -- internally and externally assessed. Jobs are used as the basis of grade structures and elements of pay progression within a pay grade/band and between pay grades/bands. In the Japanese system, individual pay levels are based on job-related ability (*shokumu suikou nouryoku*) such as skills, knowledge, attitude and behaviours, and personal characteristics (*zokujin teki youso*) such as age, years of service and academic background. Person factors make up the grade structure and pay progression. Therefore, the UK is a job-based system and the Japanese system is a predominantly person-based system.

With regard to the organisation-based system versus the market-based system, the Japanese system is characterised by the organisation-based system and the UK system is characterised by the market-based system. In the Japanese system, individual pay levels

are based on the internal assessment of individuals' value. External market value is not considered in individual pay determination. In the UK payment system, individual pay levels are based on the relative value of jobs within an organisation (job evaluation) and external market rates of the jobs (market pay). Thus, the Japanese system that considers only value assessed internally is an organisation-based system and the UK system that considers both internally and externally assessed values is a market-based system.

Both the person-based and organisation-based system, and the job-based and market-based system, are suited with each other. Concerning the person-based and organisation-based system, it is difficult to establish going rates for the value of persons in the labour market, as all individuals differ in respect to skill, knowledge, motivation, attitude and behaviours. Although the level of an individual's human capital can explain pay levels to a certain degree, as human capital theory exemplifies, the measurement concerns the general tendency on pay levels among the workers combination with similar levels in areas such as academic and vocational training. It is impossible to measure levels of individual human capital precisely in all respects. Therefore, once firms choose a person-based system, an organisation-based system is the corollary. As an alternative, the market-based system is not an available choice. However, in contrast to the person-based system, where a job-based system is widespread in the labour market, gathering data on market rate is easily possible. If firms can obtain market rates, considering the market rate for individual pay determination can gain objectivity and consistency for judgement of pay determination.

The third contrasting characteristic concerns aspects emphasised among types of person factor (value of employees) related to pay. In both Japanese and UK payment systems, person factors are used for pay progression (person factors are used for pay progression within a job grade in the UK system), but focal points in the person factor differ between the two systems. In the Japanese payment system, individual pay levels are linked to the qualification grade. The grade level is determined by the sum of appraisal rating points (see section 3.3.3). Even if employees show very high contribution and value, and their job levels are promoted to higher levels due to recognition for their high contributions, if their sum of rating points do not reach the sum of rating points set as criteria for the grade promotions, their grade levels are not promoted. In other words, the grade levels are determined by the results of appraisals in the long term. The current value of employees does not necessarily reflect the grade levels. As pay levels are

basically attached to the grade level, pay levels are determined by the results of appraisal in the long term, rather than by the current value of employees. Yashiro (2002) describes Japanese payment system as focusing on the 'stock' aspect of human capital rather than the 'flow' aspect. The 'stock' aspect focuses on the long term contribution of employees, and the 'flow' aspect focuses on the current contribution or value of employees. The refers to thesis calls this characteristic of the Japanese payment system, in which pay levels are determined based on long term contribution of employees, as the stock-based payment system.

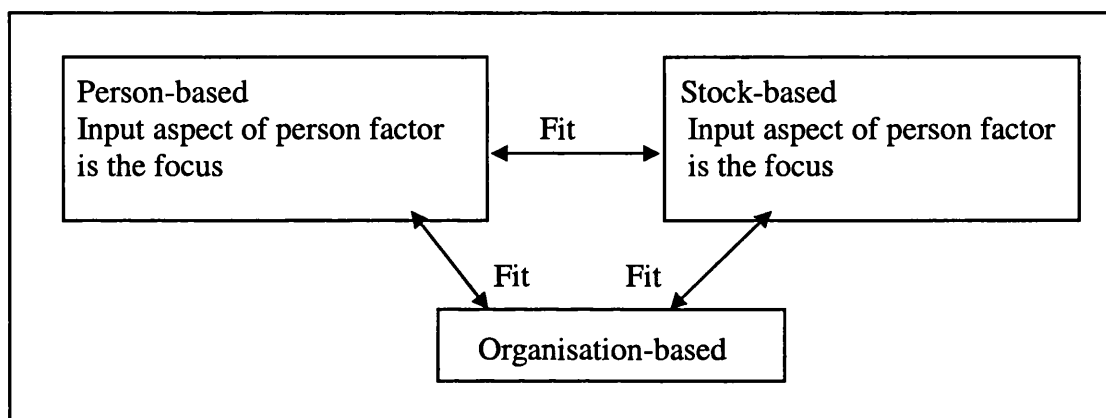
The person-based and organisation-based systems are compatible with the stock-based system, but the job-based and market-based systems are not. This is because the job-based and market-based systems essentially determine pay levels according to the current value or contribution of employee, not the long term contribution. The job is the basis of content and level of the current contribution of employees. Market pay for the job expresses the current market value of employees in the labour market as the value of the job. Therefore, the job-based and market-based system is compatible only with the flow-based system.

Under the stock-based system that the current individuals' value and contribution levels are not necessarily consistent with their pay levels, stability of pay level is desirable. This is because employees may not agree with change of their pay levels under the situation where their pay levels are not necessarily consistent with their value and contribution levels, if pay levels change time to time. The person-based and organisation-based system provides more stable pay levels than the job-based and market-based system. Pay levels can change due to a change of job assigned under the job-based system, and market pay can change in relation to demand and supply in the labour market. In contrast, although the person factor and internal evaluation can change, these changes are more gradual than the job-based and market-based system. For example, although the internal evaluation can change with a change of appraisers, the HR function can coordinate or intervene for the internal evaluation. However, the HR function cannot coordinate or intervene on the market rates. Therefore, the person-based and organisation-based systems are more suited to, or strengthen the stock-based system.

Among types of person factors, the input aspect of the person factor such as job-related

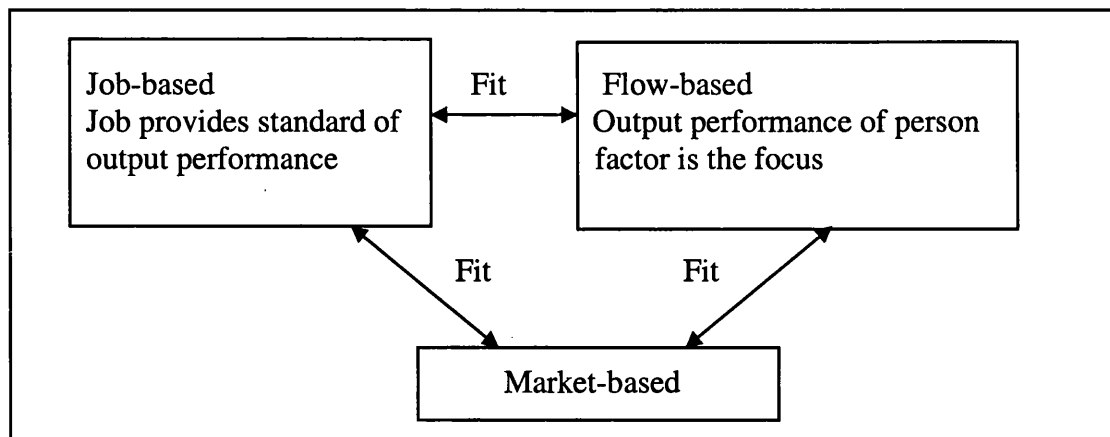
ability and personal characteristics predominates in the Japanese payment system. The input aspect is more stable than the output aspect, which can change by circumstances each time. Hence, a focus on the input aspect is suited to the stock-based payment system. As considered, the three characteristics, person-, stock-, and organisation-based payment system are suited to each other. The relationship between the three characteristics in the Japanese payment system is illustrated in figure 3-1.

Figure 3-1: Japanese type of payment system



In contrast, in the UK payment system, pay levels are attached to jobs currently assigned. External market rates for jobs indicate the current value of the job in the external labour market. The job-based and market-based payment system is well suited to the task of judging the current value of employees. Among type of person factors, the output aspect is given more prominence than the input aspect. This explains why output prominent IPRP is more widespread than input prominent competency pay. Output prominence is suited to, or strengthens, the flow-based system that focuses on the current contribution or value of employees. The content and levels of individual output performance is determined based on jobs assigned. Therefore, the job provides the standard of contents and levels of output performance in the job-based system. The relationship between the three characteristics is illustrated in figure 3-2.

Figure 3-2: UK type of payment system



(2) Relationship between type of payment systems and employment systems

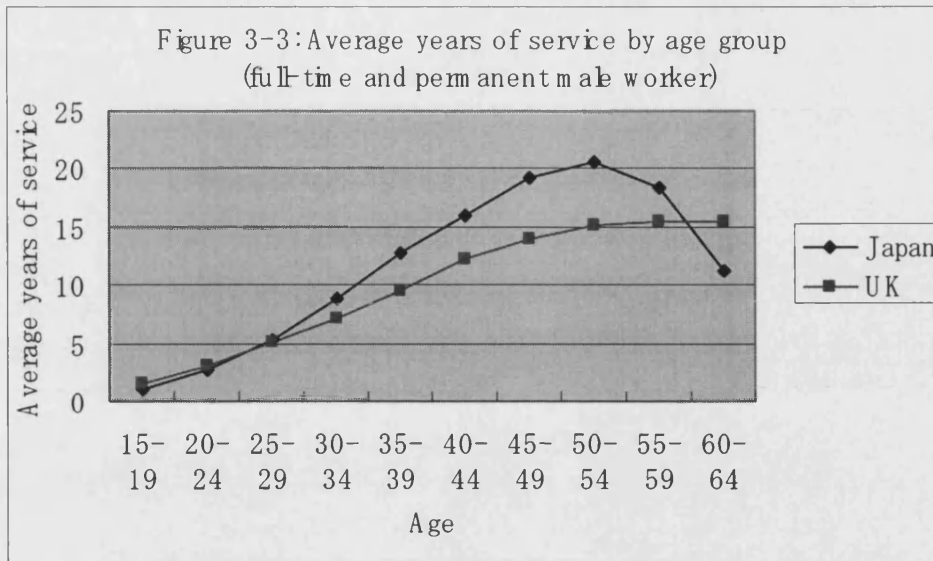
As described, the Japanese payment system is characterised as the person-, organisation- and stock-based system. However, there are problems with these three characteristics. Firstly, the person-based system can lead to divergence between pay levels and contribution levels of employees due to the lack of concrete standard for pay levels such as job content. In theory, grade and pay levels are determined according to job-related ability. However, as job-related ability tends to be general and abstract, there is practically no standard for pay levels. Secondly, judgement on pay levels in the organisation-based system is more subjective than judgement in the market-based system due to lack of more objective standards such as market pay. Thirdly, pay levels can be divergent from the current contribution levels of employees under the stock-based system.

So the question is; why do Japanese firms maintain payment systems with problems inherent in these three characteristics? The answer may be long term employment. As discussed, pay levels can be stabilised more under the person-, stock- and organisation-based system than the job-, flow- and market-based system. In addition, as the Japanese version of the person-based system includes age and years of service in the person factor, employees can predict a stable pay increase above inflation rate under the person-based system. Judgement in the person-based and organisation-based system can be more subjective than in the job-based and market-based payment system. But, if stable pay levels and a predictable pay increase are provided, subjective judgement may be acceptable for employees to some degree. Problems generated by the three

characteristics can be solved or mitigated by stable pay levels and a predictable pay increase.

However, if job security is low, stable pay levels and predictable pay increases are lost. Therefore, it is assumed that long term employment or organisation-based employment system is a necessary condition to establish the three characteristics of the Japanese payment system. That is to say, the three characteristics are suited to organisation-based employment system. The person-based system is suited to the long term employment system because, at least in theory, there are no limits on the number of person factors, unlike jobs whose number is limited by business requirements. As there is no need to link pay with the external market under the spread of the organisation-based employment system, the organisation-based payment system with no consideration of market pay rates is a desirable option. Stability in pay levels provided by the stock-based payment system is suited to the organisation-based employment system. Viewing the relationship from another angle, the characteristics of the Japanese payment system cannot be compatible with market-based employment system.

On the other hand, in the UK, job-, stock- and market-based payment system is suited to the market-based employment system. This is because these characteristics can increase objectivity and consistency in the judgement of individual pay levels, and the alignment of the pay level with the current value of an employee. Hence, it is assumed that the Japanese employment system is a more organisation-based system and that the UK employment system is a more market-based system. In fact, the average years of service in Japan are longer than in the UK as indicated in figure 3-3.



Data source: Japan Institute of Labour (2002a).

The relationships between the types of payment systems and the employment system in Japan and the UK are illustrated in figures 3-4 and 3-5.

Figure 3-4: Relationship between payment system and employment system in Japan

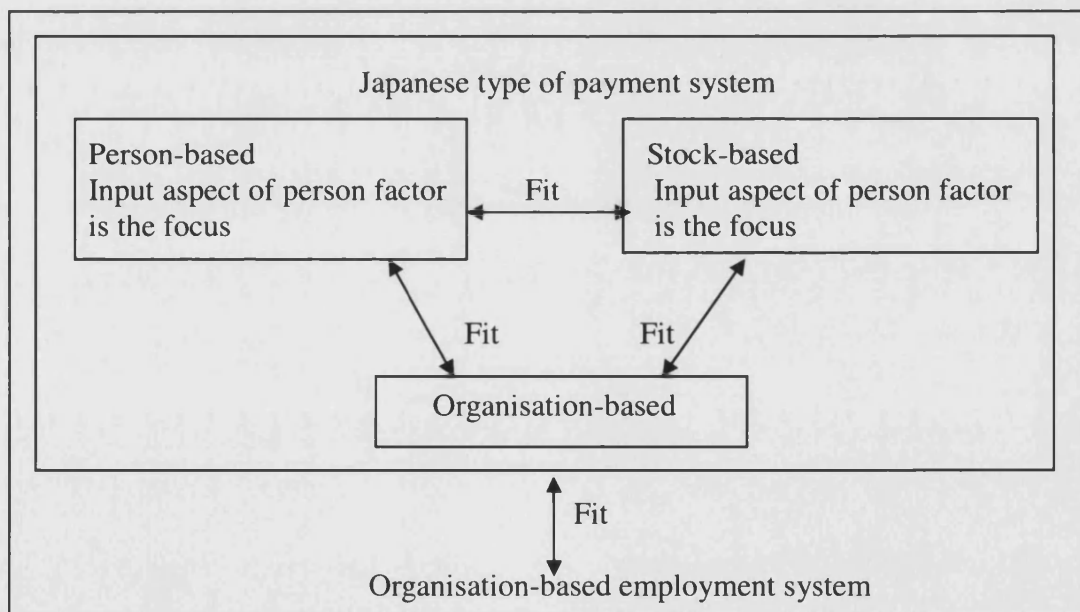
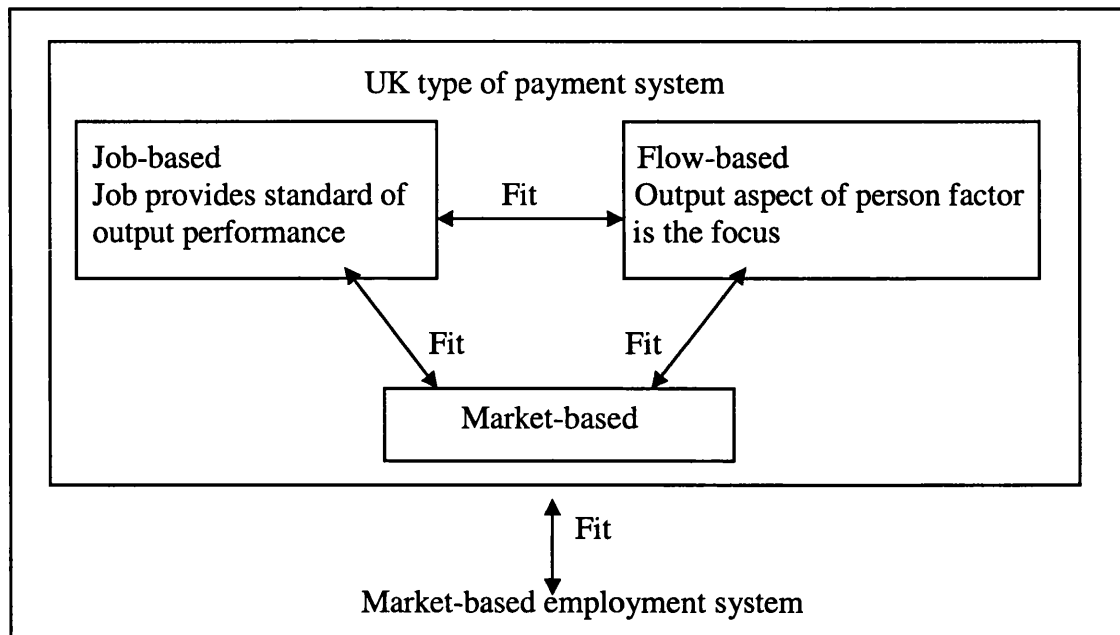


Figure 3-5: Relationship between payment system and employment system in the UK



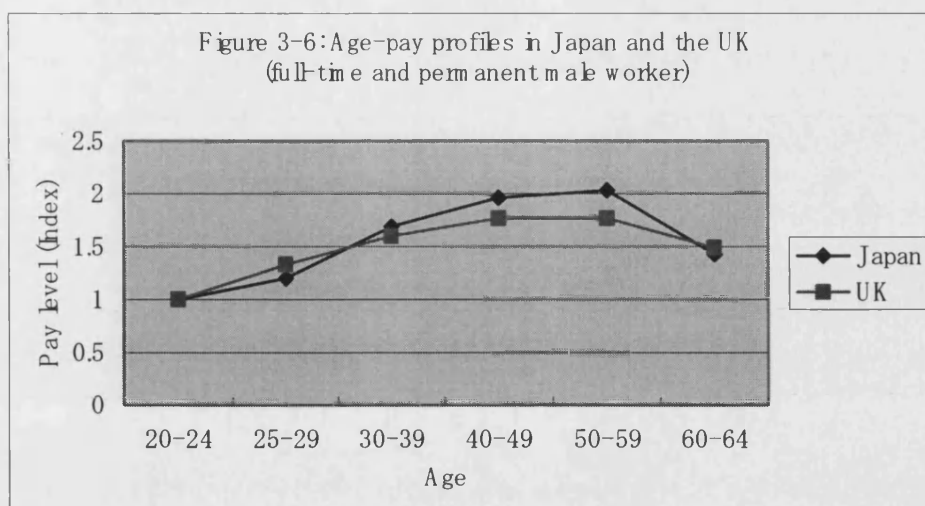
Characteristics of two types of payment system (figure 3-1 and 3-2), and two types of relationships between the two types of payment systems and the two types of employment systems (figure 3-4 and 3-5) were identified. However, these typologies express ideal types derived from relative emphasis between the two countries. Therefore, for example, the UK payment system is categorised as a job-based system, but this does not mean the UK payment system does not consider person factors. In fact, the UK organisations increasingly emphasise person factors such as IPRP, as discussed in chapter 2 and as will be discussed in chapter 7. However, many surveys found that the majority of UK organisations linked pay structure with job evaluation -- e.g. 66% (Industrial Society 1996), 68% (Industrial Society 1997) and 76% (IRS 1998). This means that the majority of UK organisations used job-based pay structures, and that they used job-based pay. In contrast, most Japanese firms used a person-based pay structure as form of *shokunou shikaku seido* (qualification system based on job-related ability) as indicated in section 3.3.3 Concerning job-based pay structures, a survey by JPCSED (1999) found that only 21.2% used a job-based pay structure that linked pay structure and job evaluation for managers, and 17.7% used them for non-managers. By this comparison, it is seen that the Japanese payment system is more person-based, and the UK payment system is more job-based.

Further, there are variations in payment systems in both Japan and the UK. For example, there are Japanese firms operating job-related pay, although they are a minority as

indicated in section 3.3.2 in this chapter. Further, the case studies conducted in the process of this research in order to gather primary data found that there are UK case study firms that put the same emphasis on input performance (such as competencies) and output performance, as will be shown in chapter 7, although output performance is generally more emphasised than input performance. In addition, the case studies also found that the extent of emphasis of long term employment differs among Japanese case study firms as will be shown in chapter 9. Therefore, the extent of emphasis on organisation-based employment system differs among Japanese firms. Accordingly, the three characteristics of the payment system of each country, and relationships between each type of payment system and each type of employment system are typical, and they do not apply to all firms in Japan and the UK in the same degree.

3.4.2 Comparison of age-pay profiles between Japan and the UK

The thesis discussed payment system concerning how to determine pay levels in Japan and the UK. Next concerns comparison of pay profiles generated as results of payment systems. Firstly, age-pay profiles in the two countries are compared. As indicated in figure 3-3, Japanese firms utilise the internal labour market more than UK firms. According to internal labour market theory, where the internal labour market is developed, long service is more positively associated with pay levels (Koike 1982, Elliott 1991, Nagano 1996, Ono 1994). In fact, as indicated in figure 3-6, the age-pay profile as a whole is steeper in Japan than in the UK. However, the age-pay profile below the 30s is steeper in the UK and the UK age-pay profile becomes flatter after the 30s. In contrast, age-pay profiles in Japan continuously increase until the 50s. The steep age-pay curve after the 40s may be the reason why Japanese pay is often considered to be seniority pay (Koike 1993, 1994, 1999).



Pay levels are indicated by index. Pay level of 20-24 is counted as 100. Data source: Japan for monthly pay (*shoteinai chingin*) by MHLW (2001c). UK for yearly pay by Office for National Statistics (2000).

Seniority pay in terms of age is another aspect -- pay dispersal within the same age groups. Even though the age-pay profile is steeper, if pay dispersal within the same age group is large, the age-pay profile is not necessarily seniority-related. This is because other reasons may be strongly related to pay levels other than age, if pay dispersal among the same age groups is large. Pay dispersal among the same age group is shown in table 3-3 and 3-4.

Table 3-3: Pay dispersal of monthly pay (*shoteinai chingin*) by age group in Japan (full-time and permanent male worker)

Age	Lowest decile	Lower quartile	Median	Upper quartile	Highest decile
All ages	65.5%	76.6%	100.0%	132.9%	173.0%
20-29	80.7%	89.4%	100.0%	112.7%	128.1%
30-39	72.0%	85.0%	100.0%	118.2%	140.1%
40-49	63.2%	79.9%	100.0%	124.5%	153.4%
50-59	57.2%	75.7%	100.0%	131.1%	166.5%
60-64	60.3%	76.1%	100.0%	137.8%	198.6%

Data source: MHLW (2001c)

Table 3-4: Pay dispersal of weekly earnings by age group in the UK (full-time and permanent male worker)

Age	Lowest decile	Lower quartile	Median	Upper quartile	Highest decile
All ages	55.6%	72.8%	100.0%	137.7%	188.6%
21-29	76.8%	95.0%	100.0%	158.6%	202.1%
30-39	58.3%	74.6%	100.0%	133.2%	181.1%
40-49	56.3%	73.0%	100.0%	134.9%	185.4%
50-59	57.1%	73.1%	100.0%	140.6%	194.9%
60-64	61.5%	77.2%	100.0%	139.0%	192.1%

Data source: Office for National Statistics (2000)

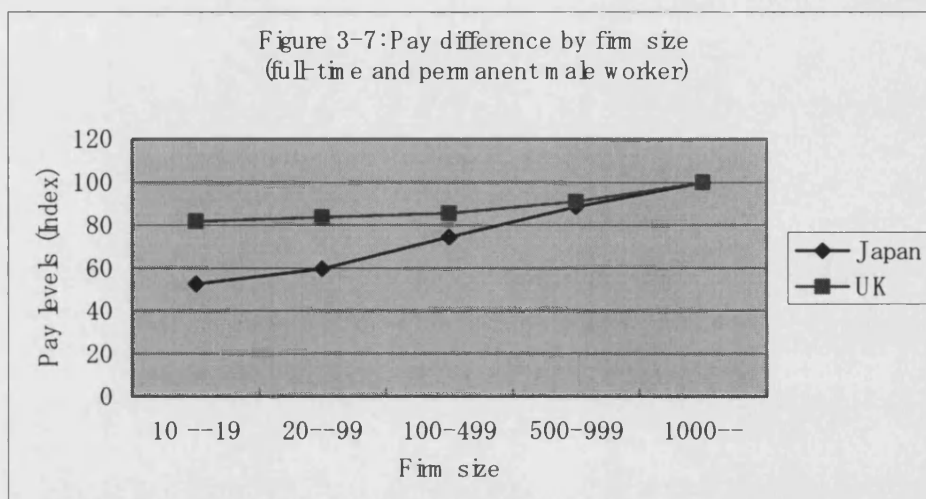
As indicated in the two tables, throughout the age groups except over sixty, pay dispersal in the UK is larger than in Japan. In particular, pay dispersal among groups with pay higher than the median is large in the UK. This indicates that a small number of workers take much higher pay levels than other workers in the UK. It can be said that pay levels in Japan are more age-related than in the UK.

3.4.3 Age-pay profile of Japanese women

It is noted that the steep age-pay profile is limited to male workers in Japan and does not apply to female workers. Pay levels for the 50-54 year age group are 1.27 times that of the pay level for 20-24 for female full-time and permanent workers. The age-pay profile for Japanese women is almost flat. Gender segregation in employment is a global issue (Rubery 1992, Rubery et al. 1997, Shaw and Clark 2000). However, there are particularly large differences in the employment relationship between men and women in Japan (Wakisaka 1997, MWHL 2001d). The gender issue may be one of the significant problems involved in Japanese management. However, the gender issue is excluded from this research, since it is too large to deal with as a sub-section. But it is important to note that the steep age-pay profile is almost exclusively a male phenomenon, and it implies that discussion of why and how the steep age-pay profile occurs, and why and how characteristics of the Japanese payment system occur, concerns only Japanese male workers. In order to equate the condition of Japan and the UK, male data is used for comparisons.

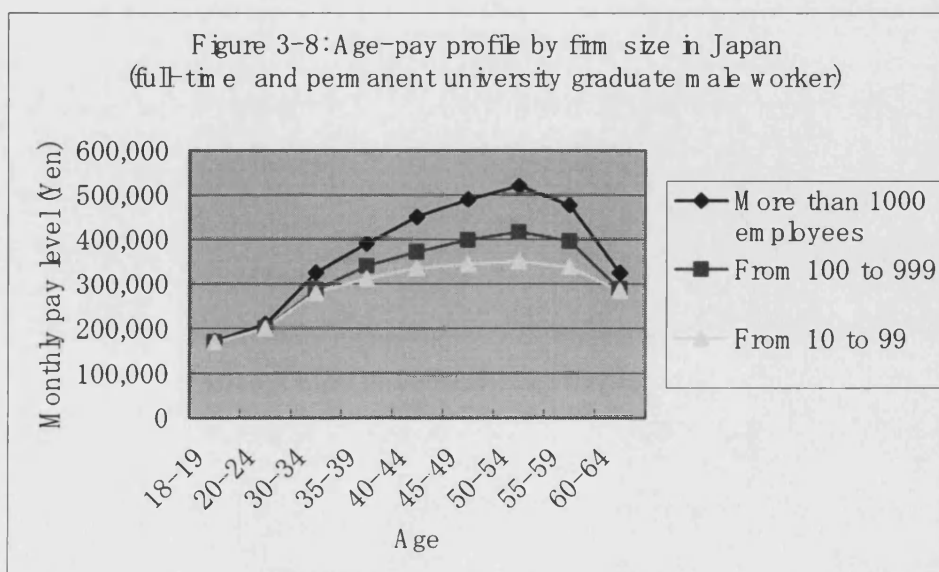
3.4.4 Age-pay profile by firm size

There are larger differences of pay level relation to firm size in Japan than in the UK, as indicated in figure 3-7. Tsuda (1970, 1987) and Hazama (1988) have identified large differences of pay and benefit levels with firm size as one of the characteristics of Japanese management. Effects by this large pay difference will be discussed in section 3.4.6 (characteristics of pay profile in Japan).



The figures are shown by index. The pay level of a firm with more than 1,000 employees is counted as 100. Data source: Japan Institute of Labour (2002a).

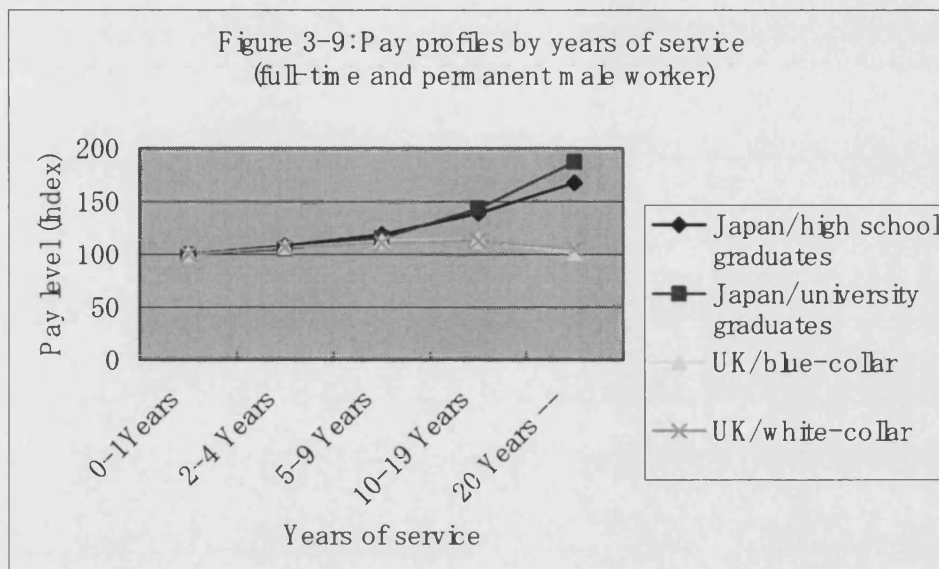
Further, the pay-age profile is steeper in large firms than small firms in Japan, as indicated in figure 3-8. It is seen that pay in large firms is more seniority-related. Effects by this large pay difference will be also discussed in section 3.4.6.



Data source: MHLW (2001c)

3.4.5 Pay profile by years of service

Age-pay profiles, which show one aspect of the seniority pay, were discussed. Now the thesis turns to the other aspect, that is, pay increases relating to years of service. Differences of yearly income by years of service are indicated in figure 3-9.



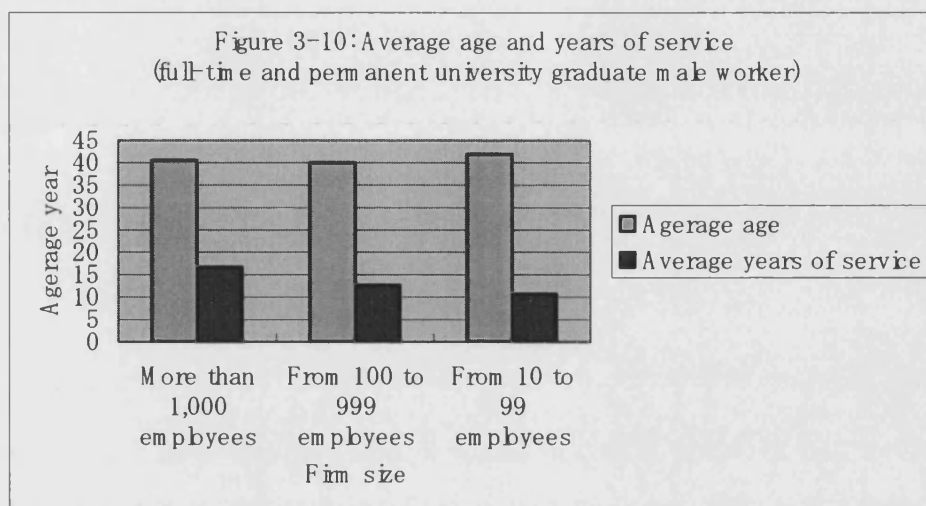
Pay levels are indicated by index. Pay level of workers with 0-1 years of service is counted as 100. Data source: Japan Institute of labour (2002a).

The figure for pay profiles related to years of service is almost flat for both blue-collar and white-collar workers in the UK. On the other hand, pay increases, age and years of service, are more closely related in Japan. Among university graduates, the age group 40-44 has 2.1 times that of the 20-24 age group, and 20 years of service attaches 1.9 times the pay of new employees. Among high school graduates, the age group 40-44 attaches an average 1.7 times the pay of the 20-24 age group, and 20 years of service attaches 1.7 times the pay of new employees. As discussed, Japanese pay levels are more seniority-related than the UK pay levels in both age and years of service.

3.4.6 Characteristics of pay profile in Japan

From the above comparisons, the following characteristics of pay profiles in Japan are found. First, pay levels are more related to age and years of service in Japan than in the UK. Second, pay levels are higher and age-pay profiles in large firms are steeper than SMEs among Japanese firms. Pay levels for Japan shown in this section are based on monthly pay. If other financial rewards such as *shoyo* (biannual regular bonus),

taishokukin (turnover money) and employee benefits are included, the difference in the levels of financial reward between large firms and SMEs are even larger. Moreover, large firms implement long term employment more than SMEs as indicated in figure 3-10.



Data source: MHLW (2001c)

Figure 3-10 also shows that large firms mostly focus on graduate recruiting. From these characteristics, it is assumed that if employees working for large firms quit their firm in the mid career, they lose large amounts of pay. Further, once they quit their firms, it is difficult to get jobs in large firms again. Therefore, employees working for large firms have few opportunities to find jobs in other firms without decreasing pay levels. They must continue to work in the same firm if they do not want to see a decrease in their pay levels. It is assumed that the large firms effectively prevent shirking of employees. This is because if employees working in the large firms are dismissed due to their shirking, they have few opportunities to get the same levels of pay and benefit again. Further, as pay increases contain an appraisal-related pay increase in most cases, the pay increase by years of service is controlled by management judgement. Pay increases by years of service is not completely guaranteed. Moreover, employees with few opportunities to find other jobs without decreasing pay levels may work hard and compete hard with other employees. This can increase organisational performance. Managements in large firms reap benefits from this.

3.4.7 Section Summary

This section compares the payment system and pay profile between Japan and the UK. The main characteristics of the two payment systems are identified as person-, stock- and organisation-based for the Japanese system; and as job-, flow- and market-based for the UK system. These two types of payment systems in Japan and the UK are well suited to their respective employment systems, which in the case of Japan is an organisation-based employment system, and in the UK a market-based employment system. The differences of the two types of payment system distinguish pay profiles in terms of age and years of service. Pay profiles relating to age and years of service in Japan are steeper than those in the UK. Further, pay levels are higher, pay-age profiles are steeper, and years of service are longer in large firms than small firms in Japan. Large Japanese firms almost exclusively focus on graduate recruiting. Employees working in large firms have few opportunities to find jobs in other large firms. These pay and employment systems in Japanese firms effectively prevent shirking and facilitate hard work for employees working in large firms.

3.5 Economic approach to seniority-related pay

The previous section revealed that pay profiles in Japan are more seniority-related in terms of age and years of service than in the UK. This section discusses the relationship between long term employment and seniority-related pay from the point of view of economic theory.

Firstly, human capital theory explains a positive relationship between long tenure and pay. Human capital theory claims that pay should increase with work experience, since skill and knowledge increase according to job experience. Skills increased by job experience are divided into general skills and firm specific skills. As firm specific skills cannot be applied to other firms by definition, workers with firm specific skills must use the skills in their own firms. Therefore, workers staying in the same firms are more willing to pay the costs for acquiring firm specific skills, as they are compensated by high levels of pay for a long time. Long service tends to be associated more with seniority pay (Becker 1975a, 1975b, Lazear 1998). Further, transaction cost theory (Williamson 1975, 1985) argues that workers with long service are likely to have large amounts of firm specific information and knowledge such as procedures, meanings and

social relationships applied only within the firm. Holding greater information can be considered firm specific human capital in a broad sense. Hence, service-related pay can be explained by human capital theory. However, age-pay profiles in Japan cannot be explained by human capital theory. Human capital theory suggests that the pay increase rate is higher in the early career stages, and becomes lower in the late career stages. The reason is that the most important skills are learned in the early career stage. Further, investment by workers to learn skills tends to be high in the early career stages, and it decreases in the later career stages (Lazear 1998). Accordingly, age-pay profiles in the UK can be explained by human capital theory, but age-pay profiles in Japan cannot be explained.

The second concerns characteristics of internal labour market. Firms cannot recruit workers with firm specific skills from labour market outside of the firms. Workers must stay in firms to acquire firm specific skills. Therefore, these workers make group within firms and firms develop firm specific payment system such as pay structure and pay progression that have relationship with years of service (Doeringer and Piore 1973, Ono 1994, Elliott 1991).

Thirdly, long term employment combined with seniority pay can prevent shirking of workers. Shirking theory claims that if the pay level is lower than the value produced by workers in the early career stage, and the pay level is higher than the value produced by workers in the late career stage, workers lose compensation if they are sacked from their companies before they are fully compensated for their value. Therefore, seniority pay can prevent shirking of workers (Lazear 1981, 1998, Elliott 1991, Ono 1994). This assumption of shirking theory presupposes long term employment.

As discussed, economic theories explain the positive relationship between long term employment and seniority-related pay. The problem is why years of service differ between Japan and the UK. Average of length of service differ between not only Japan and the UK but also between advanced countries such as the US, Germany and France (Japan Institute of Labour 2002a). Difference of length of service may be generated by particular social contexts in each country such as history, custom, economic situation and social institutions (Lane 1989, 1995, 1997a, 1997b, Whitley 1992a, 1992b, 1996, 1997, 1999, Kristensen 1997, Morgan 1997), while market economic theories do not consider social contexts. This thesis will trace back the history that led to long term

employment, seniority-related pay as the characteristic of pay profile and ability-based HRM as the basis of the person-based payment system. The historical analysis relating to payment system focuses on the person-based payment system among the three characteristics identified by this thesis. This is because the other two characteristics (stock-based and organisation-based payment systems) are covered in the discussion of long term employment and HRM related to the person-based payment system. The discussion focuses on labour management. Other factors that influence employment and payment system will be discussed in chapter 4.

3.6 History of HRM in Japan

3.6.1 Until the end of the Second World War

First of all, lifetime employment spread in post war Japan is defined. The thesis uses the definition: “long term stable employment in a firm or a firm group” (Hazama 1988:15p). The origin of lifetime employment and seniority systems (promotion and pay) can be traced back to merchants in the Edo period. But since the employment relationship in this period was a master and servant relationship, it is qualitatively different from the modern relationship (Hazama 1989, Ushikubo 1988). Lifetime employment and the seniority system for blue-collar workers in the modern economy started in some firms around the turn to the 20th century. However, life time employment and seniority system were qualitatively different from the post war version, because employers reserved the right of dismissal of workers, and only workers recognised as having high output and good attitudes by supervisors could get pay increases. Pay-by-results schemes such as piecework pay were popular payment schemes among blue-collar workers. Before the war, the payment systems of white-collar workers and blue-collar workers were clearly divided (Sekiguchi 1996, Hazama 1989, Ushikubo 1988, Kawano 1990, Tsuda 1970, 1987, 1988, Showa Doujinkai 1960).

Under the Second World War, the status of blue-collar workers directly involved in production became high under the slogan of ‘production first’. Differences of pay levels and payment systems between white-collar and blue-collar workers became small. All employees were recognized as formal members of firms for the first time in Japanese history in order to achieve the aims of the nation through cooperation of management and labour. As employee management was given prominence within the war time, the

status of the HR department became high (Hazama 1989, 1998, Ushikubo 1988, Sekiguchi 1996, Morimoto 1999, Noguchi 1995). Seniority pay was strengthened. Laws regulated that pay levels had to be determined by age, sex, academic background and length of experience, and from 1940 pay levels of all employees would have to be reviewed annually. The basic idea on pay in the war period was that pay should be based on the cost-of-living and not be linked to individual contribution. Incentive pay such as piecework pay was diminished. Age was the basis to determine cost-of-living pay (Mitani 1997, Outake 1998, Showa Doujin Kai 1960, Kagiyaama 1977).

3.6.2 Establishment of lifetime employment and seniority pay after the war

(1) History of lifetime employment

Lifetime employment practices were established during the 1950s and 1960s. Lifetime employment became a conventional wisdom or social value in the post war period. As a result, employers were limited in their right to dismiss employees (Morimoto 1999, Sekiguchi 1996, Tsuda 1970, 1987, 1988, Oyamada, et. al 1997). Later, job security was supported by judicial judgments. In 1975, the Supreme Court made a judgment that limited compulsory redundancy only to bad financial situations. The right of dismissal by employers is still today practically restricted by the judicial judgments, even though there are no statutory laws that prohibit compulsory redundancy (Anzai 1999, Furukawa 2001, Morimoto 1999, Sekiguchi 1996).

(2) Reasons for spread of lifetime employment

There are several reasons why lifetime employment became the conventional wisdom. Two reasons are mentioned here. Firstly, lifetime employment was implemented to cope with industrial disputes. After the end of the Second World War, trade unions were recognised and acquired formal bargaining power as representatives of labourers. On the other hand, the power of employers was weakened, when a large number of former senior managers were purged. Strong labour conflict happened due to serious poverty and high unemployment.

Although conflict was fierce and prolonged, the conflict was gradually relaxed and Japanese type labour management, based on corporatism between employers and

employees emerged and gradually became established. There are several reasons for this change in management and labour relations. Three main reasons are pointed out here. Firstly, power in trade union organisation shifted from *Sanbetsu kaigi* towards *Sohyo*. *Sanbetsu kaigi*, that had a close relationship with the communist party firstly took power among trade union organisations after the Second World War. The political motivation of *Sanbetu kaigi* was to realize communism and its attitude to employers was very hostile. It often initiated labour conflict. However, power gradually shifted from *Sanbetsu kaigi* toward *Sohyo* from around 1950. *Sohyo* also had political motivations derived from its close relationship with the socialist party. Its position was less radical than that of the communists. This power shift between trade union organisations mitigated labour conflict (Morimoto 1999, Ishihata 1990, Oyamada et al. 1997).

Secondly, the spread of enterprise trade unions as second trade unions whose policy was corporatism between employers and employees. After the Second World War, trade unions were formed either at enterprise level or establishment level. The first trade unions established just after the Second World War initiated labour conflict. However, during the prolonged conflict, second trade unions with more cooperative policies were established in many firms. The second trade unions were exclusively enterprise trade unions. The second trade unions in many firms gradually took power from the first trade unions. The main reason why the second trade unions took power was that employers supported the second trade unions in order to end industrial disputes by encouraging many employees to join the second trade unions. The typical method used by employers to encourage many employees join the second trade unions was provision of job security for the second trade union members. The provision of job security was not given by written rules but by implicit agreement. By the above changes, Japanese type labour management based on corporatism between employers and employees was established (Morimoto 1999, Ishihata 1990).

The third is the efforts by employers to end industrial disputes and make good relationships with employees (Tsuda 1987, Oyamada et al. 1997). Toyota may be the most notable example (Tsuda 1987). A series of articles named 'House of Toyota' described how Toyota solved its industrial disputes and cooperative relationships between employers and employees (Bungei Shunjyu 2002).

The second reason is economic in nature. The Japanese economy started to recover in the 1950s. Firms recruited many new and young employees to deal with the expansion of the economy. Seniority-related pay was utilized to reduce labour costs and long term employment was necessary to realize seniority-related pay. New technologies were introduced by advanced countries (mainly US). However, firms still needed traditional types of skill, and the speed of evolution of new technologies was not very fast. Skill transferral from middle aged and old workers to new workers through on-the-job training was the main method. Long term employment and seniority systems were useful for the skill transformation and the accumulation of organisational skill (Okubayashi 1988, Nikkeiren 1969, Kagiya 1989, Tanaka 1988).

There are other reasons too, such as the appointment of former middle managers who needed the support of employees after the war (Tsuda 1970, 1987), and the appointment of new types of managers to top management who claimed importance of public interest as well as profit of firms after the war (Morimoto 1999, Noguchi 1995, Yonekura 1993). Lifetime employment in the post war period might have been established due to a mixture of various reasons. As described, lifetime employment was established. This thesis calls a type of long term employment from graduate recruitment to retirement applied to most *seishain* (full-time and permanent employee) as a presupposition of employment regardless of organisational financial results and individual contribution spread in post war Japan as 'lifetime employment'.

(3) Introduction of formal seniority-related pay

In the pay area, seniority-related pay was further strengthened after the war. After the war, Japan faced serious poverty. Provision for cost-of-living was the most important factor in pay at the time. As cost-of-living was calculated by age, cost-of-living pay equated with seniority-related pay (Oyamada et al. 1997, Kasai 2001, Sekiguchi 1996). Further, the strong power of trade unions and weak power of employers after the war is also a reason for the establishment of cost-of-living and seniority pay. Employers compromised on the demand for provision of cost-of-living pay by trade unions because of their weak power. In 1946, *Densangata chingin taikēi*, that is the first formal cost-of-living and seniority pay applied to white-collar and blue-collar workers uniformly, was introduced in firms in the electric power industry. The *densangata chingin taikēi* became a model of cost-of-living and seniority pay, and it spread to other

industries (Kasai 2001, Oyamada et al. 1997, Kawano 1990, Miyashita 1972). Seniority-related pay also had economic rationality in the 1950s and 1960s where many firms recruited large numbers of young employees to deal with the expansion of the economy (Okubayashi 1988, Taguchi 2001, Uchida 2001, Sasajima 2001b).

3.6.3 Establishment of ability-based HRM

(1) Reasons for establishment of ability-based HRM after oil shock

Seniority systems were established after the war. One of the reasons was that pay costs could be reduced by seniority-related pay. However, the situation gradually changed from end of the 1950s to early 1960s, because the age structure gradually changed towards reduction of the relative volume of young workers. In 1969, Nikkeiren argued the need of change from the seniority-based HRM system towards a HRM system based on job-related ability (Nikkeiren 1969). The question is why HRM changed from one type of person-based system (seniority-based) towards another type of person-based system (job-related ability based). While there are various reasons, maintenance of a form of HRM compatible with lifetime employment was a major concern. This is because where job-based HRM is used, the number of existing employees are not necessarily the same as the number of jobs required by the business. Some employees can be redundant. Hence, HRM by job-related ability is a suitable method for lifetime employment, since there is no limitation on job-related ability, at least in theory (Harada 1988, Tanaka 1988, Taguchi 2001, Uchida 2001).

Ability-based HRM was systematised by *shokunou shikaku seido* (qualification system based on job-related ability) after the oil shock of 1974. The qualification system divides jobs and rewards (promotion on qualification grade and pay). The division of job and reward is the essence of this system. After the oil shock, economic growth decreased, and the expansion of organisations declined. Selection of employees for manager's jobs became necessary. So the problem became how to deal with employees who were not selected to managers' jobs under lifetime employment practices. Certain levels of seniority-related promotion and pay increase are needed, if lifetime employment is operated. The solution is the separation of jobs and rewards. Decisions on reward were more seniority-related. Divisions of jobs and rewards were a good solution in the situation of the 1970s and 1980s. Although personnel costs tend to

increase in this system, Japanese firms could afford to pay them. Retaining the motivation of employees took a higher priority at the time. Decisions for the introduction of *shokunou shikaku seido*, which divides jobs and reward, indicate the decision to maintain lifetime employment (Kusuda 1987, 1994, 2001, Ikekawa 1992, 1994, Oyamada et al. 1997, Hattori 2000).

(2) Reasons for choice of lifetime employment

As indicated, the main reason for the choice of the person-based HRM and the person-based payment system resulting in seniority-related pay is the choice of lifetime employment. The main reasons why firms chose lifetime employment after the oil shock are as follows. The first is compliance with judicial judgements. Compulsory redundancy is virtually impossible in Japan due to judgements of the Supreme Court, unless the financial situation is very bad. Secondly, lifetime employment has had social value. Hence, firms, especially large firms, can lose their good reputation if they execute compulsory redundancies. As a consequence, they can lose economic gain in the labour market, and product and service market. The third is maintenance of good employee relations. If employees change jobs, in particular when employees working for large firms change their jobs, they may lose large amounts of financial reward. Therefore, the desire of employees to work in the same firms is high. Provision of job security is important for management to keep good employee relations (Tsuda 1987, Kusuda 1987, 1994, Okubayashi 1988).

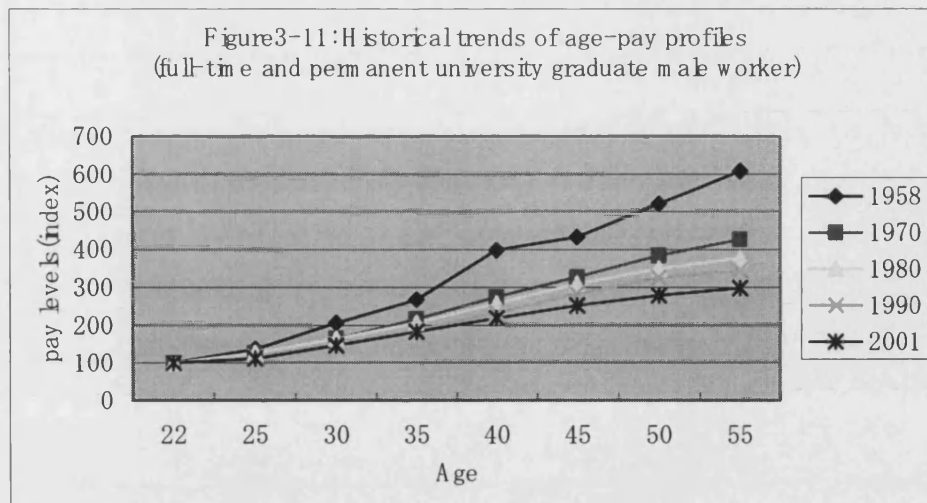
Fourthly, many firms chose the internal labour market as their focal labour market in order to increase organisational performance. Researchers argue some advantages of the internal labour market. For example, the internal labour market can reduce transaction costs (Williamson 1975, 1985, Hashimoto 1990), and the internal labour market can increase the validity of appraisal by involvement of a large number of appraisers during long term employment (Williamson 1975, Koike 1993, 1994, 1999, Yashiro 1995, 2002). In addition, Japanese firms have chosen the internal labour market under the influence of a unique situation. Many large Japanese firms have operated *gakureki betsu nenji kanri*, which is the HRM that treats one cohort with the same level of academic background who entered the firm at the same time through graduate recruiting, as one unit of employee management (Oyamada et al. 1997, Hattori 2000). Since selection of employees is generally conducted among members in one cohort, employees recognise

who are their competitors. This situation encourages competition. The late selection or late promotion practices (*osoi senbatsu* or *osoi shoushin*) implemented in Japanese firms further encourages competition. In the late selection practices, promotion differences among a cohort are not clearly revealed until the late career stage. Therefore, many competitors are involved in promotion competition in the long term, and this increases competition among employees (Koike 1993, 1994, 1999, Yashiro 1995, 2002). *Gakureki betsu nenji kanri* and late selection depend on long term employment as a necessary condition. If job security is low, as many employees quit and enter organisations throughout their career, the cohort group becomes more open and employees cannot identify who their competitors are in the open groups. If late selection is implemented under low job security, losers in the promotion competition are revealed only after the late career stage, and they are more likely to be dismissed after the late career stage. As career opportunities in the late career stage tend to be low, the late selection practices are risky for employees. If job security is low, employees that have value in the labour market may quit more than non-valuable employees in the early or mid career stage while their opportunity to change jobs is higher. As described, long term employment is a necessary condition for the late selection and the *gakureki betsu nenji kanri*.

3.7 Recent trends of payment systems in Japan

3.7.1 Historical trends and recent situation of seniority-related pay

As described in section 3.4, pay profiles especially for large firms in Japan are more seniority-related than in the UK. However, the historical trend (see figure 3-11) shows that the age-pay profile in large Japanese firms has been continuously flattening.



Subjects of the survey are firms with more than ¥500,000,000 capital and 1,000 employees.
Data source: *Chuou Roudou linkai* (Central Committee of Labour).

Moreover, many firms have strongly perceived seniority-related pay as a problem since the 1990s. Many surveys show (surveys by such as MHWL, Nikkeiren, JPCSED and Institute of Labour Administration) that many firms saw their payment system was problematic mainly due to seniority-related pay and that they plan to change their pay profiles and payment systems. For instance, a survey by Nikkeiren (1996) found that 69.4% perceived their pay profiles as being too seniority-related and 80.6% planned to change their age-pay profiles towards the reduction of seniority elements. Reduction of seniority pay has two aspects; the creation of larger pay dispersal among the same age group and the flattening of age-pay pay profiles. In the Nikkeiren survey, 63.3% of firms responded to making larger pay dispersal by increase of appraisal-related pay increase and 38.3% responded to flattening pay-age profile by decrease of pay increase of middle-age and old employees. This 'recent trends of payment systems in Japan' section summarises recent changes of payment systems based on various survey data. Data used is mainly gathered by large firms that are the target of the research.

The research identified the person-based system as one of the basic characteristics of the Japanese payment system. Further, the person-based system giving prominence to the input aspect of the person factor is well suited to the organisational-based and stock-based systems. However, this person-based system especially giving prominence to the input aspect is now subject to change. The thesis divides the direction of the change on the person-based system into three. The first is the change of contents within input-related person pay. The second is the prominence given to the output aspect of person factor. The third is introduction of job factors such as job-related pay or

role-related pay.

3.7.2 Change of types of person factors relating to pay

The introduction of competency pay is a first direction of change. A series of surveys by the JPCSED explored the rate of use of competency profiles relating to appraisal and pay. The rates of use by firms were 5.6% in the 2001 survey and 11.2% in the 2002 survey. The competency approach is a new idea in Japan (JPCSED 2000b, Motodera 2000). The two surveys show the rapid spread of the competency approach, although the rate of implementation is still low. The purpose of the competency approach in the pay area is to set concrete behavioural criteria for appraisals (JPCSED 2001). Criteria regarding skills, knowledge, attitude and behaviours in *shokunou youken* (criteria on job-related abilities) tend to be general and abstract. According to the Nikkeiren survey (2001), 56.8% answered as the criteria are general and abstract for managers and 59.5% for non-managers. This is one of the causes of seniority-related pay. Moreover, as job-related ability includes not only apparent ability but also potential ability, assessment of job-related ability is further seniority-related. The introduction of a competency profiles is one of the solutions for reduction of seniority pay by establishment of concrete behaviours relating to high contributors (JPCSED 2000b, Motodera 2000).

3.7.3 Emphasis on output performance-related pay

(1) Trends of output performance-related pay

The second is output performance-related pay. Person-based payment system in Japan gives prominence mainly to the input aspect. However, according to the survey by the JPCSED (2002) output performance-related pay has been increasingly seen give focused, 60.5% of responds agreed that “we mainly focus on output performance or result for pay and promotion” for managers, 31.8% for non-managers. “We mainly focus on input performance or ability for pay and promotion” was agreed with by 29.2% for managers, and 52.5% for non-managers (2002:2p). Hence, we can see that the output aspect of performance is focused on especially for managers. Giving prominence to output performance also means a change from a stock-based payment system towards a flow-based payment system. This is because output performance is more related to the

current value of employees than the long term contribution of employees.

(2) Concepts of yearly salary system representing output performance-related pay

One of the most up and coming output performance-related pay systems is *nenpou sei* (yearly salary system or annual salary system). Yearly salary system refers to “pay determined on a yearly basis, based on assessment of individual contribution” (JPCSED 1996b:7p). The yearly salary system expands contingency pay or ‘pay at risk’, since yearly salary levels depend on assessment of contribution level. The yearly salary system also brings individualisation of pay determination, since salary levels are determined more by individual negotiation than in other payment systems (Kusuda 1994, Ida 1995, Nagano 1996). If we decide upon the position of the yearly salary system as a continuum between job-based system and person-based system pay, the yearly salary system is somewhat biased toward the side of job-based system. This is because output performance tends to be measured based on the job (Sasajima 2001b, Nagano 1996). However, formal job analysis and job evaluation are not usually conducted in the yearly salary system. Job levels are decided by factors such as organisational level, responsibility and influence levels. As the yearly salary system is more wide spread among managers, these levels are relatively easily identified without formal job analysis and job evaluation.

As pay related to output performance has been given prominence, so too have methods for measurement of output. In Japan, MBO (management by objective) schemes are generally used as a method to measure result or output performance. 79.9% used MBO schemes linked to pay according to one survey (Sanno University 2000).

3.7.4 Introduction of job factor

The third direction is the introduction of job factors such as job-related pay or role-related pay. Job-related pay is once more given prominence, whereas it was abandoned in the 1960s in many firms. This is because job-related pay can reduce seniority pay by providing more concrete and objective standards of pay levels (Sasajima 1997, 2001b). In fact, interest in job-related pay by firms is not low. For instance, in a survey by JPCSED (2000), “very interested in job-related pay” was indicated 30.3% of firms, “somewhat interested in job-related pay” was 46.4% and “not

interested in job-related pay” was 21.0% (2000:46p). Nonetheless, job-related pay is not widespread according to surveys as indicated in section 3.3.2. A survey by JPCSED (2001) included role-related pay (*yakuwarikyu*) within the category of job-related pay (*shokumukyu*). As a result, the answer for the use of job-related pay increased from 21.1% to 43.9% for managers and from 17.7% to 24.9% for non-managers compared with the survey by JPCSED (2000a) indicated in section 3.3.2.

The reason for this increase is assumed to be the inclusion of role-related pay³⁸. The 2000 survey defined job-related pay as “pay determined based on job analysis and job evaluation” (2000:46p). Role-related pay in the 2001 survey was not defined in the survey. Therefore, the meaning of role-related pay is not clear. Instead of defining role-related pay, the survey asked for criteria used in determining the role grade. The major answers were 65.2% (level of contribution and responsibility), 54.5% (level of position), 28.0% (level of difficulty and complexity of job) and 26.5% (number of subordinates and level of people management). From these answers, the role grade system among the respondents may be similar to non-analytical job evaluation scheme. In Japan, job-related pay is generally considered as the pay based on job analysis and analytical job evaluation. Further, the author assumes that analytical job evaluation generally equates with the Hay Guide Chart. This may be one of the reasons that use of the job-related pay found by surveys is not high.

Alternatively, job-related pay can be used with higher rates than the rate captured by surveys, if job-related pay is considered using a broader concept including schemes based on non-analytical job evaluation. A survey by Toukai Research Institution (2000) indicates that the possibility of the introduction of job-related pay is high, if role-related pay is included. In the survey, answers of *yakuwari toukyu* (role grade system) for *buchou* (director) and *kachou* (manager) were 53.5% and 50.2% respectively to the question about type of grade system that the respondents will be implemented in the future as the basis of the HRM system. In the survey, answers of *shokunou toukyu* (job-related ability grade) and *shokumu toukyu* (job grade) were 34.9% and 6.6% for directors, and 37.2% and 7.9% for managers. As indicated, the role grade system has a larger rate of use than the job-related ability grade that is currently the most widespread

³⁸ There are two reasons for the estimation. One is that the possibility that use of job-related pay increased in just one year is low. One is other surveys conducted in the same period found lower rates for job-related pay such as survey by the Institute of Labour Administration (2001) indicated in section 3.3.2.

grade system.

3.7.5 Introduction of market pay

Market pay does not directly link to individual pay determination as indicated in section 3.4.1. However, an emphasis on output performance and introduction of the job factor may be gradually changing the situation. A survey by the JPCSED (2002) asked the respondents operating the yearly salary system whether or not market pay is considered for decision of the individual yearly salary levels. 43.6% answered “We consider market pay”, 40.7% answered “Now we do not consider market pay, but we will consider market pay in the future” and 19.5% answered “We do not consider market pay and we will not consider market pay in the future” (2002:6p). The survey interpreted this situation as follows

Introduction of market pay is new. In the past, Japanese firms determined pay levels only based on internal pay levels. However, as the firms recognised that ‘market pay’ (*shijyou chingin*) should not be ignored for recruiting and retention of valuable workers, they started to consider market pay rates. Market pay will be possibly introduced in Japan (2002:6p).

The concept of market pay is not clear in the survey. For instance, the survey does not identify methods for gathering market data and methods for matching pay data. Despite the ambiguity of the survey questionnaire, it does show that the respondents at least recognise ‘market pay’ (*shijyou chingin*). This is significant in Japan where the concept of market pay did not exist until recently. Nonetheless, the possibility that the respondents may have misunderstood the meaning of ‘market pay’ should not be overlooked, because more than 40% answered that we consider market pay despite the fact that methods to gather market pay rates have not been established in Japan.

All three basic characteristics of the Japanese payment system -- person-based, stock-based and organisation-based systems -- are now subject to change. Among the three characteristics, change to the stock-based system may be the largest. Change to organisation-based systems may be the smallest and the symptoms of the change have just begun to show themselves. Whereas the degree of the change differs among the three characteristics, changes to these three characteristics are significant.

3.8 Summary

This chapter discussed characteristics of the Japanese payment system, and compared characteristics of the Japanese payment system with the UK payment system. As a result, three basic characteristics are identified: the Japanese system is a person-, stock- and organisation-based payment system and the UK system is a job-, flow- and market-based payment system. In both Japan and the UK, the three characteristics fit with each other. Further, the three characteristics on both sides fit with their employment systems. In other words, the person-, stock- and organisation-based payment system fits with the organisation-based employment system in the Japan, and the job-, flow- and market-based payment system fit with the market-based employment system in the UK.

As characteristics of the payment systems in Japan and the UK are very different, this chapter traced back the historical evolution of HRM in Japan in order to reveal how and why particular characteristics of the payment system have evolved. The historical analysis revealed that the social, political and economic situation during and after the Second World War formed characteristics of Japanese HRM and payment systems, and pay profile. In particular, the main reason why many firms chose person-based HRM is the choice of long term employment, called 'lifetime employment'. The person-based HRM established after the oil shock is ability-based HRM. The reason for the choice of ability-based HRM is that there is no limit about ability at least in theory, unlike jobs whose number is limited by business requirement. Therefore, ability-based HRM is compatible with long term employment.

Another main reason that many Japanese firms chose internal labour market is to facilitate competition among employees. Long term employment combined with *gakurekibetsu nenji betsu kanri* (HRM that treats one cohort with the same level of academic background who entered the firms at the same time through graduated recruiting, as one unit of employee management) and *osoi senbatsu* (late selection) effectively facilitates competition among employees. Long term employment is a necessary condition for *gakurekibetsu nenji kanri* and late selection practices.

Japanese type payment systems compatible with long term employment look robust. However, recent surveys show change of this type of payment system toward

flow-based and job-based system. Further, Japanese firms recently began to recognise market pay. These changes seem to shift towards the UK type of payment system. This leads to investigation of change of the Japanese payment system. The next chapter will set theoretical framework and concrete research questions for the investigation of change of the Japanese payment system.

Chapter 4: Theoretical framework of the research

4.1 Theoretical Perspective adopted by the research

4.1.1 Open system or contingency perspective of organisations

As has been described in the previous chapter, Japanese and UK payment systems may be seen to fall into different categories; the Japanese system is a person-, stock- and organisation-based system, whereas the UK system is a job-, flow-, and market-based system. The question then arises as to why the systems should be so different. It could be argued that the external and internal environments surrounding the two payment systems are different in each case. That is, differences in their respective environments lead to differences in the two payment systems. This interpretation directs the research perspective towards an open system or contingency perspective of organisations.

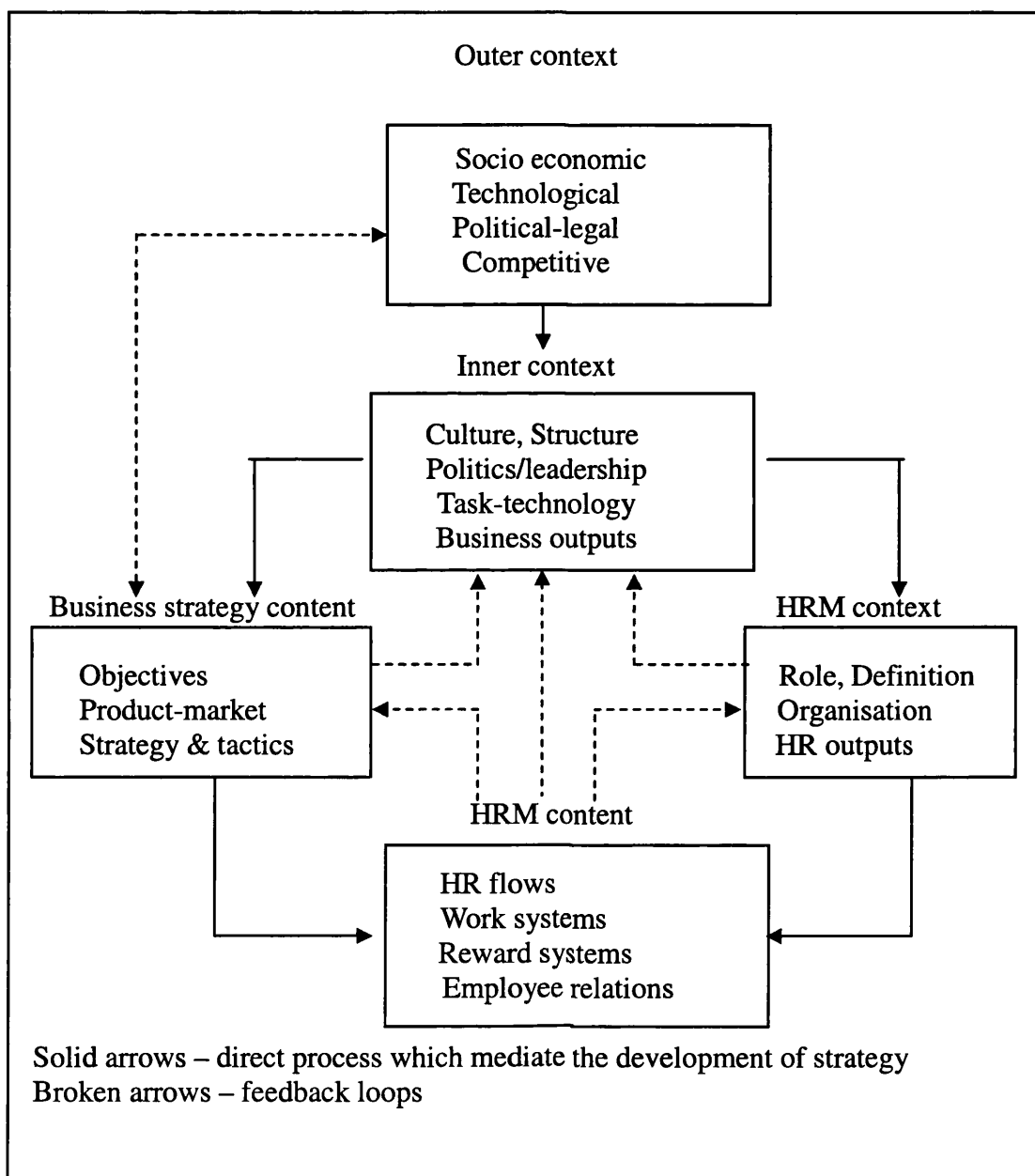
Systems theorists have described a system as “an organised, unitary whole composed of two or more interdependent parts, components, or subsystems and delineated by identifiable boundaries from its environmental supra system” (1950 Kast and Rosenzweig:103p). It is important to distinguish two perspectives in systems theory; namely closed system perspectives, and open system perspectives (Kast and Rosenzweig 1985, Burrell and Morgan 1979, Yokoyama 2001). A closed system perspective posits a system as isolated from its environment. Under a closed system, organisations are seen as predictable and controllable entities. Traditional management theories such as scientific management (Taylor 1911) and management process theory (Fayol 1985) are typically categorised as closed system models

By contrast, in the open system perspective, a system is considered to exist within a broader supra system and is characterised by an exchange with its environment. In the open system perspective, organisations engage in transactions with the environment, and changing themselves in the process (Burrell and Morgan 1979). Contingency theory regards organisations as open systems having an interactive relationship with their environment (Tosi and Hamner 1977, Kast and Rosenzweig 1985, Burrell and Morgan 1979, Lawrence and Lorsch 1977). Following the logic of an open system or contingency perspective, both external and internal factors can influence the payment system. Relationships between environmental factors and payment systems are

therefore examined. The research does not, however, presume a position of environmental determinism. Instead, actors have some room to choose their actions or how to respond to environmental forces (Whittington 1988, Child 1972, 1997).

The model of 'Strategic Change and HRM' developed by Hendry and Pettigrew (1992) is deployed (Figure 4-1). In this model, the payment system is included in the reward system. The model describes the mutual relationship between situational factors, and HRM context and content. HRM context and HRM content are open to the environment.

Figure 4-1: Model of Strategic Change and HRM by Hendry and Pettigrew (1992)



4.1.2 Three perspectives on HRM

This section discusses current HRM theory and perspective adopted by this research for HRM and payment systems. HRM theory is popularly considered in terms of three perspectives; the universalist perspective, the contingency perspective and the configuration perspective (Delery and Doty 1996, Richardson and Thompson 1999, Boxall and Purcell 2000, 2003). Each of the perspectives is described as carrying a set of basic or key assumptions.

Universalist perspective: The greater use of specific HRM practices will always result in better (or worse) organisational performance (Delery and Doty 1996).

Contingency perspective: Whether specific HRM practices result in better organisational performance or worse organisational performance depends on contingencies (i.e. external or internal factors) (Delery and Doty 1996).

Configuration perspective: A specific combination of HRM practices can be identified which generate higher business performance, but these combinations will vary with organisational context (Richardson and Thompson 1999).

Such writers as MacDuffie (1995), Delery and Doty (1996), Ichniowski et al. (1997), Richardson and Thompson (1999), Boxall and Purcell (2000, 2003), and Purcell (1999) have elaborated their characters. The defining assumption of the universalist perspective is that there is a single optimal and universally applicable practice, regardless of the internal and external factors. Emphasis is then given to internal fit among HRM practices. A contingency perspective instead emphasises the external fit between HRM practices and factors that can have a bearing on them. Strategic HRM emphasises strategy as the primary situational factor, and investigates the conditions under which a fit between organisation strategy and HRM strategy³⁹ is achieved. A configuration perspective draws on a more holistic picture to identify configurations, or unique

³⁹ There are innumerable definitions of strategy. 'Strategy' will be used in this thesis in accordance with Hax and Majluf's definition, where it describes the "establishing of the organizational purpose in terms of its long term objectives, action and resource allocation" (Hax and Majluf 1996: 2p). Strategy in organisation is considered in terms of corporate, business and functional strategies. Whilst division of corporate strategy and business strategy is critical in multi-divisional firms, the distinction between corporate and business strategies in single business organisations is blurred (Williamson 1975, Purcell and Ahlstrand 1994, Gomez-Mejia and Balkin 1992). HR strategy is one example of a functional strategy. 'Organisation strategy' in this thesis, will be understood to include corporate strategy and business strategy. Further, functional strategy except HRM strategy is included in organisation strategy.

patterns of factors that are posited as being maximally effective. These configurations are said to represent nonlinear, synergistic effects and higher-order interactions that cannot be represented within the traditional bivariate contingency perspective. Further, configuration theory assumes equifinality, that multiple unique configurations of the relevant factors may result in maximal performance. A configuration perspective then assumes that an internally consistent configuration of HRM practices can maximise internal fit and link HRM practices with alternative strategic configurations maximising external fit.

Both contingency and configuration perspectives are examples of the so called 'best fit' perspective. Boxall and Purcell (2000) include the configuration perspective within the contingency perspective, considering this the more sophisticated approach.

Research based on the contingency perspective has developed significantly in the last twenty years. The major contributions in this category include fit with the organisation life cycle (Kochan and Barocci 1985), fit with the degree and type of diversity (Galbraith and Nathanson 1978 cited in Fombrun et al. 1984), fit with market strategy, based on Porter's generic strategy (Schuler and Jackson 1987), and fit with organisation strategy, using the three categories of prospector, analyser and defender (Miles and Snow 1984). Although these contingency approaches give emphasis to external fit, internal fit among HRM practices is not ignored. In fact, these matching models propose sets or bundles of HRM practices that fit with various categories of organisation strategy as described above.

One of the characteristics of this type of contingency perspective is that it emphasises the consequences of organisation strategy for HRM practices, while the impact of HRM practices on organisation strategy has tended to be neglected. This is arguably a consequence of researchers' habits rather than any inherent flaw in the theoretical perspective of the contingency theory. Much of the research on payment systems based on the contingency perspective (such as Balkin and Gomez-Mejia 1987, 1990, Gomez-Mejia and Balkin 1992) has also emphasised the consequences of organisation strategy for payment systems and the impact of payment systems on organisation strategy has tended to be neglected. As a result, this type of research on HRM and payment systems tends to overlook the dynamism of the strategy formation process.

It is here that the configuration perspective, with a more nuanced and holistic basis, may better capture the interaction of many factors both within and outside of organisations. Therefore, the configuration perspective can overcome the shortcomings of the contingency perspective, focusing on HRM practices or payment systems matched with organisation strategy.

Since the 1990s, a significant amount of research effort has gone to testing the causal relationship between types of HRM practices and business performance, using quantitative measurements (Arthur 1992, 1994, Osterman 1994, Guest and Hoque 1994, MacDuffie 1995, Huselid 1995, Youndt et al. 1996, Ichniowski et al. 1997, Wood and de Menezes 1998). A great deal of research (Arthur 1994, Huselid 1995, Huselid and Becker 1996, Delery and Doty, Ichniowski et al. 1997) has then supported a universalist perspective. Ichniowski et al. (1996) reviewed research on the effects of best HRM practices on organisational performance (their term is 'innovative workplace practices') and concluded that the best HRM practices can improve organisational performance.

Such research illustrates that the universal best practice perspective somewhat predominates over the best fit perspective, even though there is research that supports the best fit perspective (Osterman 1994, MacDuffie 1995, Youndt et al. 1996). Pfeffer (1998) presents seven HRM practices representing the best practice perspective, based on past research. The list of Pfeffer is employee security, selective hiring, self managed teams and decentralisation of decision making, high pay contingent on organisational performance, extensive training, reduction of status differences and information sharing.

4.1.3 HRM Perspective adopted by the research

In spite of the recent ascendancy of the best practice perspective in HRM, this research adopts the best fit perspective for the following reasons.

Firstly, the universalistic best practice perspective arguably fails to explain why payment systems with very obviously different characteristics from each other continue to be used in the UK and Japan. As these payment systems with very different characteristics have been in operation for a long period, both in Japan and the UK, it is considered that both systems have rationality, notwithstanding that the ways of achieving that rationality may differ between the two countries.

Second, the best practice models proposed so far have been examined almost exclusively only in Anglo-Saxon countries. The situation of other countries has not been researched in the same depth. Moreover, proposed models of best practice are often similar to existing Japanese HRM. For instance, key components of Pfeffer's model, a high level of employee security, selective hiring, extensive training, and reduction of status differences have all been often cited as characteristics of Japanese HRM (Kono and Clegg 2001, Oliver and Wilkinson 1992). If these types of HRM truly are best practice, why do many Japanese firms persist in trying to change them? Advocates of best practice perspective have not answered this question.

Third, although a concrete relationship between HRM practices and internal and external situational factors has not been established in the best fit perspective, nor have best practices been established in both overall HRM practices and payment systems. Such HRM practices as 'high performance practices' or 'high commitment practices' have recently been popular. However, the details of these best practice models are not identical among authors. A single best practice for payment system has not been established. Wood (1996) reviewed a range of proposed best payment systems, but found they differ.

For these reasons, the best fit perspective is preferred to the more predominant universalistic perspective as it better accounts for points of difference in systems among advanced countries, such as have already been discussed -- outsider and insider capitalism (see Chapter 1), average years of service and age-pay profiles (see chapter 3), and payment systems (see chapter 3). Further, adoption of best fit perspective is consistent with adoption of open system or contingency perspective for overall behaviour of organisations by this research.

Although the best fit perspective is preferred in both the contingency and configuration perspectives, the author recognises that the best fit perspective may also contain weaknesses (Purcell 1999, Boxall and Purcell 2000, 2003).

First, matching models between organisation strategy and HRM strategy in the best fit perspective may tend to emphasise particular aspects of organisational strategy and tend to ignore other factors that may influence HRM practices such as social value and the legal framework. That is, the proposed best fit models may limit the focus to narrow

areas.

Second, there is the risk of too wide a scope. A subject may present a great number of contingencies and idiosyncrasies, if aspects such as path dependency and causal ambiguity are considered (Dierickx and Cool 1989, Becker and Gerhart 1996, Collin and Montgomery 1995). Further, since all firms have unique characteristics, research based on the best fit perspective may often yield results that cannot be applied to other firms. The second criticism of the best fit perspective is applied to the configuration perspective. As the configuration perspective views firms holistically, it tends to account for many contingencies that influence or form HRM practices. Finally, it may result in all firms having unique configurations relating to HRM practices.

However, these risks may be managed by setting the proper range of contingencies affecting the relationship between environmental factors and payment systems. Moreover, certain of the findings produced through the best practice perspective may be retained -- for example, that the structured interview based on job analysis has a higher power to predict performance than the unstructured interview with general content, or that the setting of specific and concrete objectives correlates to higher motivation and performance rather than the setting of general and abstract objectives (Cascio 1998, Vecchio 1995, Locke and Henne 1986, Batrol and Locke 2000, Kanter 1992).

This research uses a configuration perspective rather than a contingency perspective among two types of the best fit perspective. This is because a configuration perspective emphasises a combination of individual HRM practices, and this research identified three characteristics for each payment system in Japan and the UK: a person-, stock-, and organisation-based payment system for Japan, and a job-, flow-, and market-based payment system for the UK. The payment systems in Japan and the UK are seen then as configurations determined through a combination of the three characteristics.

Such authors as Arthur (1992), Osterman (1994), MacDuffie (1995) and Ichiniowski et al. (1997) support the configuration perspective, since finding that performance was higher where individual HRM practices were implemented in a consistent manner, functioning as one set or one bundle of HRM practices, rather than the aggregation of effects of individual HRM practices.

Adoption of a configuration perspective entails that, should one of the three characteristics change, the change will break the internal fit among the three characteristics of the payment systems. Consequently, other characteristics will change in order to create other types of internal fit.

4.1.4 Research questions

The perspective adopted by the research is then the open system or contingency perspective in respect of overall behaviours in organisations, and the configuration perspective in respect of the HRM and payment systems. These perspectives inform the set of research questions identified here:

- Is the bundle of elements of the payment system in Japan changing?
- If it is changing, what aspects are changing, and to what extent are they changing?
- What environmental factors have been or are influencing the change?
- Does the change of the payment system include change in the basic characteristics of the Japanese payment system identified by this research?

Further, the research will investigate.

- Why and how does the bundle of elements that make up the payment system change?
- Why and how do environmental factors influence the change?

While the research questions focus on change, they also consider aspects of continuity. Hence, the following questions will be investigated.

- For the payment system in Japan, what aspects and to what extent does the bundle of elements not change?
- Why does the payment system not change?
- What environmental factors hinder change? How and why?

The research approaches to these research questions through comparison with the UK payment system. In doing so, the research examines the same research questions to the UK payment system.

4.2 Convergence or divergence

The question of change in the Japanese payment system is related to the long lasting

debate on convergence or divergence of economic and management systems around the world. Many researchers agree that types of capitalism and management system, including the HRM system, are largely divided into market capitalism (represented by Anglo-Saxon countries) and organisation capitalism (represented by Germany and Japan) (Dore 1973, 1989, 2001, Albert 1991, Whitley 1992a, Kester 1996, Kaplan 1997). The shift of the Japanese payment system toward the UK payment system, is arguably one of the examples of convergence.

Kerr et al. (1962, 1963) suggest that countries tend to develop more similar industrial features, including industrial relations, with the progression of industrialisation. The prime driver of convergence is the advance of technology. A disciplined workforce and a larger role for government provide the infrastructure for the industrialisation.

Researchers (Berger 1996, Boyer 1996, Unger and van Waarden 1995, Lane 1995) have identified the main conditions that pave the way for convergence, such as globalisation of economic activities, government policy and regulation approach. Berger (1996) summarises three possible routes through globalisation; convergence as the triumph of market forces, abetted by complicit or passive governments, convergence as the result of diffusion of best practice and competition among institutional forms, and convergence as the internationally negotiated or coerced choice of one set of roles and institutions.

Government policy then acts effectively as a force for convergence through economic pressures making state economic policies more similar. Countries may offer similar infrastructure, tax system, inflation rates, wage levels and regulation in order to attract or keep capital, labour and markets for their goods and service (Unger and van Waarden 1995).

The regulation approach at once emphasises institutional and cultural diversity and the homogenising influence of world capitalism. Nations present a variety of institutional forms such as forms of firm, financial system, and forms of state and international regime. These institutional forms are combined to adjust for the world capitalism. These combinations may converge, where countries have similar institutional forms and respond in the same way to international competition (Berger 1996, Lane 1995).

Despite the claims of convergence of economic and management systems, a number of international comparative studies report differential characteristics in each nation or region, such as the two types of capitalism discussed. Among those studies finding differences between countries, Dore (1973) identifies partial convergence, that the British system would change to reflect a similar direction to the Japanese system. Kerr (1983, 1984) posits that convergence is a tendency that is not likely to precipitate identical systems among countries, and that while advanced industrial countries may be similar at the macro level, at the micro level they could be quite different. Nevertheless, Kerr continues to argue that convergence is a general trend.

Kousai (1996) and Kester (1996) suggest that global competition may lead to convergence, not because of the overall strength of one or another model, but because certain feature of each system are seen to have advantages that need to be combined. Kahler (1996) maintains that convergence occurs not from the strengths of a set of institutions but from rising international tensions over trade. National structures of finance, innovation, production and distribution are perceived as barriers for protection against competitors in different countries. Convergence occurs as a result of negotiation, dealing and compromise among the countries.

Boyer (1996) argues that the concept of market differs among countries. There are not common free markets across the world. Even though international markets have developed, characteristics of domestic markets differ, and production systems are influenced by different characteristics of the domestic market. Streeck (1996) maintains that national production systems hardly change, using the example of difficulties in the introduction of lean production systems in Germany, even though the need for change is recognised. Further, although they are often seen as driving forces of convergence, MNCs (Multi National Corporations) have country-of-origin effects (Coller 1996, Ferner 1994, Marginson and Sisson 1994).

Differences of opinion may derive from different levels of analysis, as claimed by Kerr (1984). Child (1981) maintains that macro level analysis for social development or research that focuses on highly formalistic and broad features of organisations tends to report convergence, whereas micro level analysis or research on informal aspects of organisations such as relationships and modes of behaviour tend to report divergence. In organisational analysis, the micro level of analysis of organisational behaviour is

associated with psychological phenomena and the macro level of analysis with socio-economic aspects of organisation (McGaughey and De Cieri 1999). In other words, organisations are becoming more similar in terms of structure and technology, whereas people's behaviour within those organisations continues to manifest culturally based dissimilarities (Alder et al. 1986). Rowley and Benson (2002) argue that concrete practices and techniques used in HRM in four Asian countries are likely to prove convergent but basic principles divergent. The convergence/divergence debate has not yet been resolved.

Recent surveys in Japan indicate such changes as increased focus on the output aspect of the person factor, introduction of the job factor for pay and recent recognition of market pay, as has been described in chapter 3. These changes seem to represent a shift towards the UK type of payment system. Through comparison of changes in the payment systems in Japan and the UK, the present research will contribute to the convergence/divergence debate.

4.3 Environmental factors affecting payment systems

4.3.1 Two perspectives on international comparative study

The approach used in this research is investigation of the relationship between external and internal environmental factors and payment systems. Therefore, the main external and internal factors should be identified. Authors provide these factors that influence HRM or payment systems. For instance, the HRM model presented by Hendry and Pettigrew (1992) (described in figure 4-1) points out factors such as the socio economic environment, trends of technology, political and legal framework and market competition as external factors, and factors such as corporate culture, organisational structure, political situation and type of leadership in the organisation, task and technology used and organisational performance, contents of business strategy, HRM context and HRM content as internal factors.

Further, as the research includes an international comparison between Japan and the UK, a discussing perspectives on the international comparison is needed. Researchers provide analytical frameworks for an international comparative study. Lane (1989) proposed four theoretical perspectives; industrialism and contingency perspectives, the

approach from capitalism, cultural perspectives; and the institutional perspective. Child (2000) uses boarder categories, distinguishing between the low context and high context perspectives. The low context perspective minimises the relevance of national distinctiveness and accounts for which forms of business organisation will be effective whatever the national location. The main concerns of this perspective are market mechanisms and the impact of technology. As the market mechanism and technological progress impact on all business organisations regardless of country, this perspective does not emphasise social context in each country, and assumes that managements and organisations around the world will eventually converge. In contrast, the high context perspective emphasises national differences of management and organisations, and assumes that organisations are embedded within a distinct system of business and culture. The high context perspective presumes that management and organisations will retain and develop their own distinct characteristics that derive from cultural preference and are embedded in social institutions (Child 2000). Child further identifies three approaches for both low context and high context perspectives as follows.

The low context perspective

Economics: The main concern is market mechanisms and it seeks to establish the conditions to achieve effective management and organisation in a free market.

Technology: This emphasises technology as the prime mover of capitalism.

Psychology: This approach assumes that all humans basically share common needs and motivational structure.

The high context perspective

Cultural theory: People's thinking and behaviour are significantly governed by cultural values. Culture differentiates management across nations and other social collectivities. As cultural values are deep seated and enduring, culture is thought of as being immutable.

Cultural information theory: This categorises national culture by degree of codification and diffusion of knowledge. Codification is the degree to which knowledge is expressed by words or figures in order to deliver the meanings to other people precisely. Uncodified knowledge is that knowledge whose basis remains intuitive, and cannot be precisely expressed by words or figures (Boisot 1986).

Institutional theory: This emphasises the idea that management and business have different institutional foundations in different societies. Key institutions are the state, the

legal system, the financial system and the family. It stresses the historical embeddedness of social structure and processes. Institutional analysis acknowledges the significance of culture, but it allows the possibility of cultural modification. Whereas cultural theory regards culture as an immutable given, institutional theory recognises that institutions and behavioural norms adapt to economic and technological forces, despite often doing so slowly, and with some resistance.

Child's classification is advanced here as appropriate as the framework for analysis of the environmental factors, due to its assimilation of the contributions made by recent international comparative studies (McGaughey and De Cieri 1999, Rowley and Benson 2002, Storey et al. 1997, Lane 1989, 1995, Dore 2001, Sparrow et al. 1994), situational factors in proposed HRM models (such as the Michigan model, the Harvard model and the Warwick model⁴⁰), factors in contingency approach for payment systems (Balkin and Gomez-Mejia 1987, 1990) and factors considered in the formation of a global compensation system (Milkovich and Newman 2002). Applying the perspective of Child's classification (2000) to the framework presented earlier by Lane (1989), the industrialism and contingency perspective, and approaches from capitalism would seem to identify with the low context perspective, and cultural and institutional perspective with the high context perspective.

4.3.2 Specification of environmental factors

Internal and external environmental factors need to be specified within the low context and high context perspectives. First of all, the high context perspective is considered. It is suggested that of the three approaches Child (2000) identifies with the high context perspective, institutional theory is most appropriate to the present inquiry.

Lane (1989) has noted problems of applying cultural theory to research questions. First, it may be difficult to specify the content of a national culture that has influence on business organisation. Despite the difficult, without the required level of detail, culture may easily become a black box. Second, it may also prove difficult to demonstrate that the culture identified actually influences organisational structure and behaviour in organisations. Third, of course, not all members in a given society or group share the

⁴⁰ The Warwick model is a 'Model of Strategic Change and HRM', by Hendry and Pettigrew described as figure 4-1.

same value and beliefs; moreover, where they are shared, the strength by which they are affected by them may not be equal. Fourth, as empirical study confirms, people may believe in a value, but fail to behave in accordance with it. The sorts of problems potentially involved in such an application of cultural theory are avoided here; such constructs as individualism, power distance and uncertainty avoidance (Hofstede 1980, 1991, Triandis 1998, Bjerke 1999) are not explicitly considered in regard to the payment system, although a background knowledge of cultural theory may be useful. Institutional theory may be said to include culture as a background social institutions (Whitley 1992a, Selznick 1957). Hence, culture is not neglected.

Cultural theory presents a number of conceivable levels of analysis where social groups are concerned. For example, Hofstede (1991) distinguishes six levels; national level, regional and/or ethnic and/or religious and/or linguistic affiliation level, gender level, generation level, social class level and organisation or corporate level. The high context perspective tends to focus on the national level, and informs international comparison. Of Hofstede's six levels, the organisation or corporate culture level is important in the study of organisations. Institutional theory considers this level of culture an important factor (Selznick 1957, 1966, Scott 1998, Meyer and Rowan 1977). Corporate culture is said to have two aspects -- a sociological aspect, and a psychological aspect (Bjerke 1999), by dint of which it may also be admitted as a facet of the psychological approach in the low context perspective.

Cultural information theory (Boisot 1986) categorises national culture by degree of codification and diffusion of knowledge as has been described. Japanese culture is typically categorised as having low levels of codification and diffusion. British culture is thought of as having a moderate degree of codification but a high level of diffusion of knowledge. To the extent that cultural information theory belongs to the wider body of cultural theory, and in light of the abstract nature of its constructs, its categories do not inform the specification of environmental factors here.

Institutional factors are then used as the most significant factors in the high context perspective. Whitley (1992a) distinguishes two types of social institutions, in proximate social institutions, and background social institutions. Background social institutions concern the more basic characteristics of human behaviour and relationships in a society, such as degree and basis of trust between those not of kin. Background institutions are

those formed over the long term, dating back to the pre-industrial era. Proximate social institutions constitute the more immediate business environment, and have been formed during the process of industrialisation under the general influence of background institutions. Proximate social institutions exert a direct influence upon the business system⁴¹. Background social institutions may influence the business system only indirectly.

Proximate social institutions are taken as institutional factors due to the directness of their influence, although background institutions are not ignored. Whitley (1992a, 1992b, 1996, 1997, 1999) presents a number of key proximate social institutions, such as role of the state, the financial system, and education and vocational training systems. Whitley considers the business system as having three parts; the system of governance, of market organisation, and of work. Whitley's list informs the selection of factors in the institutional context here, though factors discussed by other authors are also used (the major references are indicated below table 4-1).

The major factors in the high context perspective are listed on the right side of table 4-1.

Table 4-1: Environmental factors in low context and high context perspectives

Factors in low context perspective / contingency factors	Factors in high context perspectives / institutional factors
<ul style="list-style-type: none"> - Global and national economic situation - Position of a country in the world economy - Situation of domestic and global competition in an industrial sector - Position in an industrial sector in domestic and global scales - Situation of labour market in national, sectoral and regional levels - Situation of industrial relations of each organisation - Policy of the government - Laws, Rules and regulations 	<ul style="list-style-type: none"> - History of a country (especially date of industrialisation and process of industrialisation) - Role and policy of the government - Laws, Rules and regulations including tax and social security system - Education system including vocational education and training system - Culture, custom and rules in society and sectors - Financial system - Characteristics of business system in a

⁴¹ Definition of business system used in this thesis is "particular arrangement of hierarchy-market relations which become institutionalised and relatively successful in particular context" (Whitley 1992a: 6p)

<ul style="list-style-type: none"> - Ownership structure - Corporate governance structure - Financial system - Speed of change in product and service market - Type of technology used - Speed of change in technology - Effects of globalisation - Organisation strategy (e.g. business areas, types and process of diversification, pattern of linkage between business units) - Size of an organisation (sales turnover, number of employees) - Organisational performance (financial result) - Organisational structure - History of an organisation - HRM strategy - Occupational composition - Types of skills, knowledge and competencies held by employees - Perspective and reaction of employees - Corporate culture - Leadership style - Interest and intention of actors in an organisation 	<ul style="list-style-type: none"> country (e.g. type of market organisation, type of ownership structure, type of corporate governance structure, type of organisation strategy, type of industrial relations, type of work system) - Effects of globalisation - History of an organisation - Perspective and reaction of employees - Corporate culture - Leadership style - Interest and intention of actors in an organisation (new institutional theory does not emphasise interest and intention of actors, but it does not ignore their existence of them)
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Notes: Although environmental factors are divided by low and high context perspective, the line of separation is not always clear cut. Many factors such as the history of an organisation, policy of government, corporate culture, type of ownership structure, type of corporate governance structure, and type of financial system are included in both low and high context perspective as indicated in the text. Examples of how the same factors are included by both perspectives are shown in the text (see page 101).

Some factors such as policy of the government, laws, rules and regulations are generally considered high context factors. However, the author judged these factors can also be low context. For example, the government changed its policy towards deregulation and it changed concrete laws, rules and regulations in order to realise its deregulation policy. These changes changed the market situation towards increasing market competition for some case study firms in both Japan and the UK as will be described in chapter 9. In this respect, the policy of the government, laws, rules and regulation can be considered part of the low context perspective.

The author categorised situation of industrial relations in each organisation into low context perspective. This is because situation of industrial relations among firms in one country differs. This is exemplified by the case study firms. That is, some UK case study firms recognise trade unions as pay negotiation bodies for some categories of employees. Some UK case study firms

do not recognise trade unions as pay negotiation bodies as will be described in chapter 7. In Japanese case study firms, one firm does not have enterprise trade union and other nine firms have enterprise trade unions. Further, six firms negotiate pay increase rates with their trade unions for non-managers through collective bargaining, and four firms do not negotiated pay increase rate with their trade unions.

Main references: Lane (1989, 1992, 1995, 1997a, 1997b), Dore (1973, 1989, 2001), Scott (1987, 1998), Meyer and Rowan (1977), Meyer et al. (1983), Whitley (1992a, 1992b, 1997, 1999), Quack and Morgan (2000), DiMaggio (1988), DiMaggio and Powell (1983, 1991) Wilkinson (1996), Burrell and Morgan (1979), Gomez-Mejia and Balkin (1992), Balkin and Gomez-Mejia (1987), Child (1972, 1981, 1997, 2000), Lupton and Gowler (1969), Fombrun et al. (1984), Schuler (1992), Kochan and Barocci (1985), Schuler and Jackson (1987), Miles and Snow (1984), Hendry and Pettigrew (1990, 1992), Beer et al. (1984), Selznick (1957, 1966), Whittington (1993), Lawrence and Lorsch (1977), Porter (1999), Schien (1999), Bjerke (1999), Hofstede (1980, 1991), Rousseau (1995), Rousseau and Ho (2000), Sparrow (1998), Schein (1999), Guest and Conway (2001), Folger and Cropanzano (1998)

As for the low context perspective, there is no comparable list of factors. Instead, factors have been derived and compiled from a variety of sources, such as those HRM models presented so far, the Michigan Model, Harvard Model and Warwick Model, research on strategic HRM such as the various matching models between organisation strategy and HR strategy, and various researches on the contingency approach to organisations and payment systems.

Factors in psychology are combined into three factors 'employee's perspective and reaction', 'corporate culture' and 'leadership style'. Employee's perspective and reaction include factors such as the psychological contract and motivation. Motivation is often the focus of research on payment systems as discussed in chapter 2. Psychological contract is the perception of both parties to the employment relationship, organisations and individuals, of the reciprocal promises and obligations implied in that relationship (Guest and Conway 2001). Pay is an important tool for the making of psychological contracts, because employers can convey messages on issues such as value, performance standards, time frames and equity through pay (Rousseau 1995). In the concept of psychological contract, organisational change tends to generate negative reaction from employees, including decreasing motivation, since employees tend to regard change as a breaking of the psychological contract (Rousseau 1995, Rousseau and Ho 2000, Sparrow 1998).

Corporate culture is treated on a number of levels. For instance, Schein (1999) posits three levels; the level of artefacts, that of espoused value (strategy, goal and philosophy) and that of basic underlying assumptions (unconscious, taken-for-granted beliefs, etc.).

Leadership style influences many aspects such as employee attitudes, motivation and corporate culture (Bass 1985a, 1985b, Bjerke 1999, Schein 1999, Vecchio 1995), something known to institutional theory (Selznick 1957). As the psychological approach is incidental to this study, these sorts of constructs are not extensively or specifically developed.

The major factors in the low context perspective are listed on the left side of table 4-1.

The environmental factors listed in table 4-1 are not exhaustive. Indeed, were all factors to be considered, an intractable number of contingencies could be introduced, resulting inevitably in the conclusion that all are unique.

Although environmental factors are usefully considered as relating to low and high context perspectives, the line of separation is not always clear cut. Many factors such as the history of an organisation, policy of government, corporate culture, type of ownership structure, type of corporate governance, and type of financial system are included in both low context and high context perspectives. Their allocation may depend much on the means or modes of their influence. For example, if a firm selects a particular financial system through deliberate considerations of economic efficiency, the financial system may be considered as a low context factor. A financial system may however spread throughout society over a considerable period of time, and its selection may offer the firm a better – even the only chance of securing survival. Further, actors in the firm may have come to take a particular system for granted. The financial system may then become a high context factor. Likewise, a firm may choose to place emphasis on employees' interests among a variety of shareholders' interests, because it judges that this best increases competitive advantage. Emphasis on employees' interests in this case may be considered a low context factor. Equally though, such an emphasis on employees' interests could spread throughout society over time, and penalise firms making other choices, costing them social legitimacy and economic gain. Again, in such a situation, an emphasis on employees' interests may be a high context factor.

4.4 Characteristics of institutional theory and comparison with contingency theory

Since this research uses institutional theory as a framework for the high context perspective, the thesis summarises the main characteristics of institutional theory. This section also describes similarities and differences between institutional theory and contingency theory. As environmental factors are allocated to the low context and high

context perspectives, so factors in the low context perspective may be regarded as contingency factors, and factors in the high context perspective may be regarded as institutional factors. The reason why factors in the low context perspective correspond to contingency factors are that contingency theory emphasises adaptation to environment, but it is a culture free approach and concerns a technical environment that consists of factors in the low context perspective such as market competition, technology used, and size of organisation (Child 1981, McGaughey and DeCieri 1999). Concrete reasons are indicated through the following discussion on similarities and differences between institutional theory and contingency theory.

The first proposition of institutional theory is that an organisation should adapt to the external environment in which it exists. Adaptation to environment is essential for the survival and development of the organisation (Meyer and Rowan 1977, Meyer et al. 1983, Scott 1998, Perrow 1972). Institutional theory may be said to be described by the open system model in much the same way as contingency theory. This is because institutional theory emphasises that adaptation to the external environment is critical for organisations for their survival (Perrow 1972, DiMaggio and Powell 1991). There are some two main versions about how external environments influence organisations and how organisations respond or influence the external environment. In one version the external environment and organisations mutually influence each other (although influence by external environment is larger than the reverse relationship). The other position sees external environments penetrating organisational boundaries, therefore, internal and external environments become blurred (DiMaggio and Powell 1991, DiMaggio 1988, Myer and Rowan 1977, Selznick 1957, 1966, Oliver 1991, 1997).

Second, environments in institutional theory include not only the technical environment, whose focus is market competition, but also the institutional environment, which concerns the social and cultural environment. Institutional theory posits that adaptation to the institutional environment is important if an organisation is to achieve social legitimacy. Organisations derive economic benefit not only from the advantages of their product or service market, but also from their position in society (Myer and Rowan 1977, Scott 1983, Meyer et al. 1983).

Meyer et al. (1983) categorise organisations according to the relative importance of their technical and institutional environments. Organisations that face technically

complex environments, it is argued, should place more emphasis on the technical environment for survival; conversely, organisations that face institutionally elaborate environments should give more emphasis to the institutional environment for survival. Factories are cited as an example of the former case, whilst educational institutions are cited as an example of the latter case. The degree of institutionalisation is higher than in educational institutions than in factories. Notwithstanding this emphasis, organisations need to adapt to their institutional environment, and are in fact institutionalised. It is essential that organisations gain legitimacy, identity and meaning in society and for members (Scott 1998).

Contingency theory, as has been said, considers adaptation to environment, but its main concern is the technical environment. Contingency theory presents organisations as economic entities, and does not particularly consider such aspects of organisations as having identity and meaning aside from the economic aspect (Lawrence and Lorsch 1977).

Third, institutional theory argues that actors do not necessarily decide and behave rationally (DiMaggio and Powell 1991, Yokoyama 2001, Scott 1998). There are two perceptions on actors in organisations; the rational actor model and the natural actor model (Yokoyama 2001). The natural actor model views actors as not necessarily behaving rationally according to organisational aims. Actor's impressions of whether they behave rationally is a subjective judgement. Even though actors think that they behave rationally, their behaviours are boundedly rational and decisions relating to performance programmes in organisations are based on a satisfactory standard not an optimal standard (Simon 1965, March and Simon 1958, Cyert and March 1963, Urabe 1974, Urabe and Sakashita 1975).

The rational actor model regards that actors decide and act rationally according to organisational goals. The typical rational actor model is a closed system model of management theory such as scientific management and management process theory. Yokoyama (2001) argues that contingency theory by Lawrence and Lorsch (1977) is also categorised by the rational actor model, since it emphasises how organisations function on division and coordination of tasks to deal with a rational environment such as market competition. However, as contingency theory considers conflict between divisions and how conflicts are solved, contingency theory is not a typical rational actor

model in this aspect.

Although institutional theory continues to purport that actors do not necessarily decide and behave rationally (DiMaggio and Powell 1991, Yokoyama 2001, Scott 1998). institutional theory has gradually shifted from a focus on normative factors to cognitive factors (Scott 1987, 1998, DiMaggio and Powell 1991). Scott (1998) presents three institutional factors as being coercive, normative or cognitive factors and discusses how these sorts of factors function for institutionalisation. Scott's classification of institutional factors is indicated in table 4-2.

Table 4-2: Institutional factors

	Coercive	Normative	Cognitive
Basis of conformity	Convenience	Social responsibility	Taken-for-granted
Mechanism	Coercive	Normative	Mimetic
Logic	Instrumentality	Appropriateness	Tradition
Indicators	Regulation, law, sanction	Permission, license	Spread, isomorphism
Basis of justification	Legal approval	Morality	Cultural support, Conceptual accuracy

A number of writers (DiMaggio and Powell 1991, Scott 1998, Yokoyama 2001) have reviewed the historical evolution of institutional theory, and described a shift in the focal point from normative factors to cognitive factors. Institutional theory that focuses on the cognitive process, and cognitive limitations of actors assumes that once procedures or ideas are habituated, people tend to think of these procedures as given -- they are taken-for-granted --, and tend to lose sight of alternatives. Such institutional theory that focuses on cognitive process is referred to here as new institutional theory, and institutional theory that focuses on normative factors, as old institutional theory (DiMaggio and Powell 1991). The work of Selznick (1957, 1966) that is sometimes said to represent old institutional theory (DiMaggio and Powell 1991, Yokoyama 2001) takes the view that actors do not necessarily act to achieve organisational aims, due to their own interests. In new institutional theory, the interests of and conflicts between actors are deemphasised, although they are not ignored (DiMaggio 1988, DiMaggio and Powell 1991, Scott 1998, Yokoyama 2001).

Fourth, as institutionalisation is a process of adaptation to the social environment,

organisations in the same society or organisational field tend to become similar, and tend to have distinctive characteristics according to the society or field they inhabit. Scott (1998) identifies six levels as units of analysis in institutional theory, which are; world system, social level, organisational field, organisational population, individual organisation and organisational subsystem. Of those levels, the main concern of new institutional theory has been the social level and organisational field (Scott 1998).

DiMaggio and Powell (1983:149p) define an organisational field as “organisations that, in the aggregate, constitute a supplier, resource and product consumers, regulatory agencies, and other organizations that produce similar services or product”. DiMaggio and Powell claim that organisations within the same organisational field tend to become similar, while the similarity does not necessarily mean greater effectiveness. Three mechanisms of institutional isomorphism are proposed; coercive, mimetic and normative isomorphism. These three mechanisms are consistent with the three institutional mechanism indicated in table 4-2.

If the assumptions of DiMaggio and Powell (1983) regarding institutional isomorphism are applied, behaviours of organisations within the same society tend to be similar. In fact, research on institutional characteristics at the national level found that behaviour of organisations in the same country tends to be similar (Lane 1989, 1995, Albert 1991, Kristensen 1997, Kim and Hoskisson 1997). Moreover, new institutional theory assumes that organisations are embedded in society, and institutional environments penetrate organisations. Accordingly, the distinction between internal and external environmental factors becomes blurred (DiMaggio and Powell 1991, Scott 1998). This is the reason why internal and external factors are not divided in table 4-1 . On the other hand, old institutional theory tends to focus on the institutionalisation process in each organisation and regards boundaries between organisations and the external environment as identifiable (Selznick 1966, DiMaggio and Powell 1991).

The contingency theory also considers individual organisations and regards organisational boundaries as being identifiable (Tosi and Hamner 1977, Kast and Rosenzweig 1985, Burrell and Morgan 1979). A theoretical distinction may then be drawn between internal and external factors in the low context perspective. Factors are not divided into internal and external factors in table 4-1 to avoid potential overlaps –

for instance ownership structure and corporate governance structure⁴² are often regarded as both internal and external.

Fifth, once organisations are institutionalised, they tend to be stable, although institutionalists do not ignore change. Organisations gain legitimacy in society through adaptation to the institutional environment. Institutionalised organisations provide their own sets of meanings and identity for members. Institutionalisation provides organisations with stability in their society. Moreover, new institutional theory emphasises the unreflective and taken-for-granted nature of actors' decisions and behaviours (DiMaggio 1988, DiMaggio and Powell 1991). Though change may occur, it tends to be slow due to resistance of members; changes in institutionalised structure or deinstitutionalisation may involve changes in power relationships between members (Lane 1995).

Oliver (1991, 1997) criticises institutional theory for overemphasising the unreflective nature of actors and the external control of organisations, and she claims that actors in organisations choose their reaction more strategically, and that the control between external environment and organisations is rather more of a mutual relationship. Oliver (1991) proposes five types of strategic responses to institutional process; acquiesce, compromise, avoid, defy and manipulate. Pfeffer and Salancik (1978) also propose several mechanisms whereby organisations positively function to change their external environments.

Contingency theory views organisations as economic entities. It does not particularly consider social identity or value to organisations and the cognitive process of actors. Also, it does not emphasise the resistance of actors to change (Lawrence and Lorsch 1977).

4.5 Characteristics of proximate social institutions and business systems in Japan and the UK

Institutional theory provides for a description of the characteristics of proximate social institutions and business system in each country. The thesis summarises the main characteristics of social institutions and business systems in Japan and the UK based on

⁴² These sorts of factors may similarly be regarded as contingency and institutional factors, as has been discussed.

Whitley's categories (1992a, 1996, 1997, 1999). Neither the low context perspective nor contingency theory distinguish environmental context in each country. Account is made of the financial system, the role of government, education and vocational training systems and the importance of the skill certificate as proximate social institutions, and shareholder structure, corporate governance structure, and work system as business systems. The choice of these factors is based on a relatively strong and direct relationship with the employment and pay areas.

First of all, factors in the proximate social institutions are discussed. The first factor is the financial system. The financial system in advanced countries is largely considered as either credit-based or capital-based. Japan's system is categorised as a credit-based financial system. Under this system, banks are encouraged to share risks with their borrowers, since the banks' success depends on the loanbooks of particular clients. The credit-based system enables state agencies to intervene in the allocation of resources and to direct firms' choices through banks. Government, in the credit-based financial system, tends to share the risks with firms. Risk sharing by banks and the government makes firms' financial situations more stable. This enables firms to adopt a more long term perspective for business. In addition, the firms do not have to internalize risk by diversification, especially in unrelated areas, under risk sharing by banks and government. Japanese firms tend then to focus on a single industry (Whitley 1992a 1992b, 1999, Kaplan 1997, Kester 1996, 1997).

These characteristics arising from the credit-based financial system encourage the adaptation of a long term perspective, and long term employment. As long term employment becomes widespread, the external labour market situation is increasingly unlikely to be reflected in individual pay determination, and pay levels tend to be seniority-related (Whitley 1992b, Noguchi 1995, Elliott 1991, Koike 1982). Evaluation and reward of employees tends to be based on long term contribution rather than the current value of employees (Yashiro 2002). Further, managers are internally promoted, tend to have direct business experience of their firms, and do not have to rely on financial results to assess employee's contribution. Employee evaluation tends to be on an input basis, considering such factors as skills, knowledge and behaviour (Gerhart 2000, Batrol and Locke 2000).

The UK financial system is categorised as a capital-based financial system⁴³. Firms raise capital in a variety of ways depending on relative cost and terms. The relationship between financial institutions and business firms tends to be short term and specific to particular transactions. Long term risk sharing between financial institutions and business firms is low. As the state cannot intervene in firms' decisions or channel funds toward particular sectors under the capital-based financial system, the government does not share risks with firms. The absence of risk sharing by banks and government encourages business short termism. Further, firms are more likely to diversify into unrelated areas and activities of business in order to stabilise their financial situation by dispersal of risks, and activities of business are coordinated through financial control. Firms tend to see their business as a business portfolio and the success of each business portfolio is measured by financial performance. This type of business planning encourages short termism of business units, and the direct relationship of pay with business unit performance (Lane 1995, Dore 2001, Marginson and Sisson 1994, Kaplan 1996, 1997, Franks and Mayer 1997, Goold and Campbell 1987, Gomez-Mejia and Balkin 1992).

Under the short termism for business and employment, long term employment and investment for employees are relatively small. As a result, evaluation of employees tends to be based on their current value rather than their long term contribution. Accordingly, job-based and market-based payment systems are suitable payment systems, and the output aspect of the person factor tends to be given more prominence than the input aspect. Further, as many managers are recruited in the middle of their careers, their working experience of their employees is relatively small. As a result, evaluation for employees tends to rely on organisational and individual output performance rather than on individual input performance such as skill, knowledge and behaviour (Gerhart 2000, Batrol and Locke 2000). In addition, link between business unit financial result and pay is strengthened in portfolio management (Miles and Snow 1984, Goold and Campbell 1987)

The next factor is the role of the government. In the credit-based financial system, the

⁴³ During the 19th century, lending by regional banks became common finance method, but after some damaging over extension, it became confined mainly to short term credit. London-based banks were not widely involved in finance of industrial firms. Towards the end of the 19th century, finance began to be raised by the sales of equity, and the stock market soon became the most dominant source of outside finance (Lane 1995).

government can intervene in the allocation of resources and direct a firm's choice. Therefore, the government tends to be 'developmental type' and it shares risks with firms (Whitley 1992a). In Japan, The Ministry of Finance controls the flow of finance under the bank system through various regulatory means such as interest rates, control over opening bank branches and finance through state owned banks. The Ministry of International Trade and Industry (MITI)⁴⁴ also executes its industrial policy through *gousei shidou* (administrative guidance) (Noguchi 1995, Matsumura 1997, 2000, Whitley 1992b). However, since the mid 1980s, as regulations on equity financing have been eased, equity financing of Japanese firms has increased. As a result, the influence of the Ministry of Finance has been weakened (Prowse 1994, Kaplan 1997).

In the UK, the government cannot intervene to finance of firms under the capital-based financial system. The government is characterised as 'regulatory type' (Whitley 1992a). As the dominant institution of the central government was established pre-industrialisation, the political elite are unlikely to regard economic development as a criterion for judging the success of their career. The UK government had a *laissez-faire* doctrine for economic policy in the 19th century. This prevented interference of the state in economic activities. Although the government started to intervene in industry in the post war period, policies of the Treasury and the independent Bank of England are sometime inconsistent, having a negative impact on industrial policy. Major institutions are controlled by separate bodies such as professional institutions and independent public corporations. The government has difficulty implementing industrial policy in a consistent manner using these structures in economic activities. Therefore, the UK government is unlikely to become involved in development of industry (Lane 1989, 1992, 1995, Kristensen 1997). As a result, firms internalise risks by holding diversified business activities.

The nature of the role of government in Japan, by enabling firms to take a longer term perspective in business, has a similar effect to a credit-based financial system on employment and payment systems. Conversely, the nature of the role of the government in the UK encourages businesses to take a more short term perspective, having effects analogous to a capital-based financial system regarding employment and pay areas in the UK.

⁴⁴ MITI was restructured to form the Ministry of Economy, Trade and Industry in 2000.

Another factor among the proximate social institutions is education and vocational training systems, and the importance of the skill certification system. In Japan, academic success is crucial for selection by elite institutions. Vocational training is generally given low prestige, and is relatively poorly funded. Instead, employers must provide practical training by themselves. Such training tends to be task and firm specific. The skill certification system has not progressed, a situation which reduces workers' external mobility. Firms' actions within the organisation are not checked by the presence of external standard specialist skills. Firms are able to invest in employee training and development, and to rely on their internal promotion systems without fear of poaching (Whitley 1992a, 1992b, 1999).

In the UK, publicly certified skills and professional expertise are highly significant. Managers and workers are highly conscious of their professional and craft competencies, and of their market value. Loyalty and commitments to their own career and identities are greater than to their employers. These characteristics facilitate inter-firm mobility and increase the risk of skilled employees leaving the firm. Pays are related to generalised and certified skills. This high level of skills standardisation and certification limits an employer's ability to organise tasks and responsibility idiosyncratically and change these through unilateral judgement. Firms are not encouraged to invest in employees who are considered to be at high risk of leaving (Whitley 1992a, 1999, Lane 1989, 1995, Marginson and Sisson 1994).

These features of education and vocational training, and the importance of skill certification in the two countries have comparable effects to the financial system and the role of government for employment and pay.

The next group of factors concerns the business system. The first factor is shareholder structure. Shareholder structure in advanced countries is largely divided into two types. In one type, shareholders consist of a small number of major shareholders with a business relationship. Long term business success of the firm is then given higher priority than short term capital gain for these shareholders, who consist of a small number of major shareholders. In the second type, shareholders consist of a large number of minor shareholders with no comparable relationship. The interest of the shareholders is rather capital gain (Franks and Mayer 1997, Kester 1996, 1997, Kaplan 1997).

Japan is regarded as an example of the former system⁴⁵. Shareholders are less likely to sell their shares due to movements in share price and dividends under the system. Hostile take over rarely occurs (Whitley 1992a, 1992b, Short and Keasey 1997, Prowse 1994, Franks and Mayer 1997). Further, the major shareholders in large firms often hold shares mutually. Where this is the case, the shareholders tend to demand less in the way of profit, share price and dividends. Were shareholders to make such demands, the same could in turn be demanded of them. Cross shareholding is mainly practiced among large firms. Large firms often hold shares of small firms, but the reverse situation hardly occurs. Though top management teams in large firms are hired managers, they are shareholders under cross shareholding. Where shares are held between firms, management teams can be released from consideration of outsider shareholder interests. Accordingly, these firms are unlikely to emphasise short term shareholder's interest (Okumura 1979, 1998, Suzuki 1998, Shimotani 1993).

The UK is categorised as an example of the latter system in which shareholders consist of a large number of minor shareholders⁴⁶. Shareholders in the UK tend to pursue profit maximisation, high share prices and high dividends. Managers are required to maximize profit in the short term. A hostile take over is relatively easy in this shareholder structure. If firms fail to make profits, the sanction for firms is often a hostile take over. As firms must pursue short term profit maximisation, they tend to have a short term perspective for business and employment (Short and Keasey 1997, Kim and Hoskisson 1997 Prowse 1994).

These characteristics stem from the types of shareholder structure in Japan and the UK, and have similar effects to those of other institutional factors discussed in relation to employment and pay. Further, as Japanese firms do not have to emphasise the shareholder's interest, they are unlikely to make an explicit link between those interest

⁴⁵ The historical trend of shareholding structure in Japan is: 69.1% (individual), 5.5% (business firm), 9.9% (financial firm including bank, investment trust, pension fund and insurance firm) and 12.6% (security firm) in 1949, 39.9% (individual), 23.1% (business firm), 15.2% (bank), 15.1% (insurance firm) and 1.2% (security firm) in 1970, 23.1% (individual), 25.2% (business firm), 26.2% (bank) and 17.3% (insurance firm) in 1990 (Zenkoku Shoken Torihikisho Kyougikai 2001).

⁴⁶ The historical trend of shareholding structure in the UK is: 54.0% (individual), 6.4% (pension fund) and 10.0% (insurance firm) in 1963, 28.2% (individual), 26.7% (pension fund) and 20.5% (insurance firm) in 1981, 17.7% (individual), 34.2% (pension fund) and 17.3% (insurance firm) in 1993 (Short and Keasey 1997).

and their payment system. In contrast, in the UK shareholder structure, the principal (shareholders) and the agent (management) are different persons. Agency problems become one of the more salient issues in the design of the payment system. An explicit link between shareholder value and payment system is one of the solutions (Franks and Mayer 1997, Bruce and Buck 1997, Gerhart 2000, Welbourne and Balkin 1995).

The second factor in the business system is the corporate governance structure. In Japanese firms with a small number of major shareholders and a credit-based financial system, major shareholders can gather large amounts of information including insider information. Should firms have problems, shareholders may intervene directly and explicitly to correct them. Such intervention is usually led by firms' main banks (Whitley 1992b, Kester 1996, 1997). As firms do not have to consider the interests of minor shareholders with no business relationship, due to their small influence, firms tend to give higher priority to employees than minor shareholders. This encourages high job security and high investment in employees.

In the UK, share ownership is highly dispersed. Neither shareholders nor banks become closely involved in management decisions (Lane 1995). Corporate control by shareholders to limit agency problems is in theory conducted through monitoring and control by a non-executive director and a system of pay for performance and management incentives. Shareholders execute their power through either requiring change of management policy, or by threat of exit or actual exit from their position. Exiting by selling their shares, is the method most commonly used by shareholders (Franks and Mayer 1997, Short and Keasey 1997). Firms are then required to achieve short term financial results to prevent the exit of shareholders.

Corporate governance structures in Japan and the UK have similar effects as the three factors in the proximate social institutions and shareholder structure for employment and pay.

The final factor is the work system. Whitley (1997, 1999) categorises type of work systems in the world into five types as Taylorist, Delegated responsibility (Negotiated and Paternalist) and Flexible specialisation (Artisanal and Patriarchal). The Japanese work system is categorised as Paternalist among the five types. In this category, the workers discretion and involvement is considerable over task performance. But the level

of worker control over job definition and allocation is low. Under the high level of decentralisation of operational control and the high level of work group autonomy, job fragmentation and role specification are low. Tasks are allocated to groups. The contents of assigned jobs are not clearly defined and everyone crosses boundaries in performing their work (Whitley 1992b, 1997, 1999, Koike 1994, 1999). Accordingly, pay is not linked to jobs. The person-based system is a suitable payment system, since it is more flexible and is not limited by allocated tasks. Moreover, as tasks, skills and roles are not clearly specified, especially among white-collar workers, evaluation criteria for employees tend to be general and abstract, rather than specific and concrete. This reduces the validity of each specific appraisal. A stock-based payment system is then a suitable method.

The UK work system is categorised by Taylorist among the five types. Under the Taylorist principle, job fragmentation, and task and role specification is high. However, the application of Taylorism in the UK is inconsistent and ambiguous mainly due to the relatively low level of technical training and skills of managers. Managers tend to rely on workers to solve technical problems. However, in the mass production industries, the division of labour is high, many workers are not skilled, and now the UK is highly dominated by large firms. Managers cannot delegate responsibility to workers (Lane 1989, 1992, 1995). Under high role specification, job-based payment system is a suitable method. With high separation of managers and workers, employer commitment to the security of employment is low, and the market- and flow-based payment systems are suitable methods.

Work systems in Japan and the UK have similar effects as other institutional factors discussed in this section for employment and pay.

4.6 Summary

This chapter firstly discussed theoretical perspectives adopted by this research -- the open systems or contingency perspective for overall organisation behaviour, and the configuration perspective for HRM and payment systems. The identification of the perspectives led to research questions to achieve the research objective. The approach to pursue the research questions was also identified as investigation of relationships between environmental factors and payment systems.

Next, the low context and high context perspectives presented by Child (2000) as a theoretical perspective to consider environmental factors in international comparative research were determined as most appropriate. Further, the main theoretical frameworks for the high context and low context perspectives were identified; institutional theory for the high context perspective and contingency theory for the low context perspective.

Then, the key features of institutional theory were discussed, and features of contingency theory were also discussed in comparison with institutional theory. Moreover, the characteristics of six factors among proximate social institutions and business systems in Japan and the UK were discussed. The six factors are selected because their influence on payment systems is relatively stronger compared with others.

Chapter 5: Research design and methods

5.1 Research methods

This chapter discusses the research methods which will help answer the research questions set out in the previous chapter. In order to answer these questions, the relationships between payment systems and environmental factors need to be examined. There are many environmental factors, both internal and external, that could influence payment systems, and these are intertwined in a complex manner. We cannot expect the existence of a simple one-to-one relationship between specific environmental factors (causes) and payment systems (effects). The research also recognises a reverse causal relationship between environmental factors and payment systems. Furthermore, the conscious intentions of actors, and the social and political situation within an organisation (Cyert and March 1963, Child 1972) need to be taken into account. It must be recognised that organisation strategy, which is one of the main contingencies acting on payment systems, is itself a dynamic process of formulation and implementation (Mintzberg 1978).

Data is needed which can capture the effects of environmental factors, but the recognition of complex processes, including the intentions of actors and the social and political situation, must also be studied carefully. A detailed understanding of these issues is necessary to answer the questions of 'how' and 'why'. Qualitative data expressed mainly in words is needed to capture such a complex process (Miles and Huberman 1994, Seale 1999, Bryman 1988, 1989). Furthermore, rich understanding can be powerful in assessing causality and can identify complex mechanisms, going beyond mere association relationships. In contrast, quantitative research can only infer causality. It can identify the relationships between causes and effects, but tells us little about how and/or why it exists. Researchers can only guess the mechanisms involved (Miles and Huberman 1994, Seale 1999). Analytical surveys have problems in establishing relationships of causes and effects for several reasons. Firstly, as surveys do not manipulate independent variables and dependent variables, they generate problems of causal interpretation. For instance, survey researchers are not sure that the relationship between an independent variable and a dependent variable is a real one, nor whether

each of these two variables is associated with a third one (extraneous variable)⁴⁷. Survey researchers are also not sure whether a relationship between two variables is direct or is through another intervening variable (Bryman 1989, Gill and Johnson 1997). Secondly, notions of causality are usually taken to imply that a cause precedes an effect. But as surveys often gather data on variables of interest simultaneously, survey researchers face problems relating to what is a cause and what is an effect (Bryman 1989). These disadvantages can reduce internal or construct validity⁴⁸. Hence, qualitative research is a necessary tool for this piece of research.

At the same time, gathering quantitative data is desirable in order to understand payment systems precisely and increase the level of understanding. For example, quantitative data such as pay levels and ranges for each pay band/grade, market pay rates for the main jobs or job families, pay increase rates for each employment level (or grade level) and each rating point can increase the level of understanding of why particular types of payment systems are chosen and how payment systems are operated. Furthermore, a high level of understanding leads to precise analysis of the causal relationships between environmental factors and payment systems. Knowledge about the quantitative aspects of pay and payment systems is important for the analysis of payment systems.

To summarise, gathering qualitative data is necessary for generating a rich understanding of context and processes within organisations, and for enabling an explanation of causal relationships. In addition, gathering quantitative information is desirable for increasing internal or construct validity in the research. Therefore, an important question is what research method enables the gathering of both qualitative and quantitative data?

The case study is the research method that enables the gathering of a rounded picture of a situation or event from the perspective of all the persons involved, usually by the use of a variety of both qualitative and quantitative methods. Subjects of case studies are

⁴⁷ An extraneous variable is “a phenomenon whose variations might cause some variation in the dependent variable and thus provide rival explanations of any observed variability in the dependent variable to that suggested by the independent variable” (Gill and Johnson 1997: 177p).

⁴⁸ This thesis uses the definition of “the extent to which conclusion regarding cause and effect are warranted” (Gill and Johnson 1997:179p) as indicated in chapter 2

one or more selected examples of a social entity such as a community, social group or organisation. A case study can provide a more rounded, holistic picture than any other research method through the intensive study of a small number of social entities (Hakim 1992, Yin 1994, Bryman 1988, 1989, Sayer 1992). The case study methodology was adopted for this research since it is arguably the best method of gaining a holistic picture.

Although case studies can have both qualitative and quantitative aspects, they are often described as an example of qualitative research. In fact, qualitative research almost equates with the case study within organisation studies (Smith 1991, Bryman 1989, Sayer 1992). However, the difference between them is that the case study may gather not only qualitative data but also quantitative data, depending on the objectives and situation (Bryman 1988, 1989, Yin 1994). In fact, there are case studies that gather large amounts of quantitative data such as conducting surveys in case study firms (Storey et al. 1997).

A case study can be used for exploratory, descriptive and explanatory purposes (Sanders et al. 2000, Yin 1994, Bryman 1989, Stake 1994, Hakim 1992). Exploratory purpose is to find out “what is happening to seek new insights; to ask questions and to access phenomena in a new light” (Robinson 1993:42p cited in Sanders et al. 2000:97p). Exploratory purpose is to clarify your understanding of a problem. Descriptive purpose is to portray an accurate profile of persons, events or situations in order to have a clear picture of the phenomena on which the researcher wishes to collect the data. Descriptive research may be an extension of exploratory research. Explanatory research seeks to establish causal relationship between variables and explains relationships between variables (Sanders et al. 2000).

5.2 Conditions for selection of case study firms

After choosing the case study method as the primary data gathering method, the next question relates to the conditions for selecting the case study firms (called case firms from here on). The purpose of setting conditions for this selection is to reduce any extraneous variables. The research objective is to investigate the direction of change in Japanese payment systems by comparison with UK payment systems. Four conditions are set for selecting the case firms in order to reduce extraneous variables in this

international comparative study. They are sector, organisational size, ownership and industrial sector.

The first decision relates to whether the firms should be from the private or public sector. The research selected the private sector as the research target, as discussed in chapter 1.

The second decision relates to firm size. The author selected large firms, as discussed in chapter 1. This research uses the number of employees to define firm size, because it is often used in research in the HRM area. The condition used in this research as the criterion for 'large' is firms those with more than 1,000 employees, although the author recognises that size measured by number of employees compared with that measured by sales turnover can be very different by industrial sector. The author also recognises that the reported number of employees in Japanese firms tends to be under-stated, since many Japanese firms account only for *seishain* (full-time and permanent employees). The concept of *seishain* in Japan is narrower than the concept of full-time and permanent employees in other advanced countries (Japan Institute of Labour 2002b).

The third decision relates to ownership. This concerns overseas-owned firms in Japan and the UK. Many overseas-owned firms are operating in both countries. The country of origin effect in the area of HRM is a well-known phenomenon (Coller 1996, Ferner 1994, Marginson and Sisson 1994). The overseas-owned firms in the two countries concerned may be influenced by the parent firm and this influence is thought of as an extraneous variable. Therefore, overseas-owned firms are excluded from the research. However, the inclusion of one UK-owned firm in Japan is deliberate. The firm was previously Japanese-owned and was taken over by one of the UK case firms in 1999.

The reason for selecting one UK-owned firm in Japan is to reveal the characteristics of the payment systems that Japanese and UK practitioners may regard as taken-for-granted. If they regard them as taken-for-granted, they are less likely to understand and be able to explain why they use a particular type of payment system. Consequently, the characteristics regarded as taken-for-granted cannot be analysed. HR practitioners in the acquired UK-owned firm (Company JT3) may see similarities and differences including taken-for-granted aspects, and an understanding of the payment systems in Japan and UK can be improved by uncovering these taken-for-granted aspects.

In fact, Company JT3 gave the author information about various taken-for-granted aspects, and this gave insights to the research. For example, Company JT3 changed its appraisal procedure so that line managers are required to agree objectives and ratings with their staff through benchmarking with the parent firm. The name also changed from *jinji kouka* (appraisal) to performance review. At the same time, the firm delegated the final decision making on ratings to line managers, although the corporate HR department coordinated ratings before the change. The firm felt that line managers must have the decision making power in order to make agreements. Furthermore, after the change, many line managers claimed that the change of grade system from person-based to job-based is necessary. This is because, as contribution levels, grade and pay levels tended to diverge under the person grade system, line managers often had difficulty in agreeing with their staff, and line managers needed some concrete standards by which to set levels of objectives and performance reviews. Jobs can provide concrete standards in various ways, such as task content, and level and width of responsibility. The firm changed its grade system from a person-based to a job-based system. This process in Company JT3 indicates that once the firm requires agreement between line managers and staff about objectives and ratings, concrete standards for levels of objectives and ratings is needed.

In contrast, during this research, the UK case firms only mentioned a cascading process for setting objectives at first, and did not mention setting objectives based on job accountability. After further questioning by the author, interviewees in the UK case firms mentioned objectives being set based on job accountability. This may be an issue which is taken-for-granted by UK practitioners. However, this is a significant difference in comparison with the Japanese payment system. The author asked the UK case firms further questions, because the author knew about process of change from the person-based to the job-based system in the UK-owned firm (Company JT3) in the early stages of the research. Making agreements, delegating decision making power to line managers and setting objectives based on job accountability were new to the Japanese HR practitioners in Company JT3. That is why they emphasised the above issues. Their perspective revealed significant differences between Japan and the UK in aspects that are likely to be hidden by people who know only one side.

The fourth decision relates to the industrial sector. The industrial sector can influence

many issues such as organisation strategy, HRM practice and the characteristics of employee profiles. For example, Porter (1999) notes that the competitive situation regarding market and profit levels differ between industrial sectors. These differences can affect the employee profile and HRM practice, including in the area of pay. Therefore, the industrial sector is an extraneous variable and extraneous variables should be reduced. For this research, five industrial sectors were selected as matching industries in Japan and the UK. They are telecommunications (called telecom from here on), food and drink, chemical and pharmaceutical, retail and oil. The case firms are selected from among these five industrial sectors.

5.3. Types of employees studied

There are many types of employees within an organisation. As payment systems are very complicated, studying the payment systems for all types of employees would make the focus of the research less clear. Therefore, the types of employees studied were specified. The first condition is to limit the research target to full-time and permanent employees. There are large differences in HRM practices between full-time and permanent employees (*seishain*) and other types of employees (*hi-seishain*) in Japan. Characteristics of Japanese HRM such as long term employment, seniority-related promotion and pay, and enterprise trade unions are almost exclusively characteristics of *seishain*. Therefore, the subject of the research is limited to full-time and permanent employees.

The second condition is the exclusion of top executives. Payment systems of top executives are generally different from other employees. Furthermore, pay levels and the procedure for determining pay levels differ between Japan and the UK. Pay levels for top executives in the UK are higher than those in Japan (Institute of Labour Administration 2001, Price Water House Coopers 2001). The levels of financial reward for board members in listed firms in the UK are determined by remuneration committees, and these committees disclose the reasons for their decisions (Bruce and Buck 1997, Inagami 1997, Ezzamel and Watson 1997, Sharman 1997). There is no such obligation in Japan⁴⁹. The structure of boards also differs between Japan and the UK. In

⁴⁹ New corporate law was introduced in order to increase the disclosure of corporate information in 2003. While there are various concepts in the new law, one of them is that firms can choose either the establishment of remuneration committee or an increase in the power of auditors for the determination of financial reward of board members.

Japan, most executive boards are made up of the heads of business units or functions and they are rarely directly involved in corporate strategy (Tachibanaki 1995, 1997, Inagami 1997). In the UK, the function of the corporate board and business unit managers is divided. The former engages in corporate strategy and the latter engages in business unit strategy (Inagami 1997, Franks and Mayer 1997). Hence, the function of corporate boards differs between the two countries. These differences may partially be the cause of differences in pay levels and procedures for the determination of financial rewards between Japan and the UK. Because of these differences, the research excludes top executives. The investigation of top executive pay is too large an area to treat as one area of this research.

The third condition is the exclusion of female employees. As indicated in chapter 3, the pay profile in Japan is significantly different between men and women. Seniority-related pay, which is the main characteristic of the Japanese pay profile, is almost exclusively applied to men. Gender segregation is a serious problem in Japan. However, this research excludes gender issues from the research, since the issue is too large to study as one area within this research in the same way as the aforementioned top executive pay.

5.4. Issues of validity and generalisability

5.4.1 Problem of generalisability from case studies

The main problem with case studies is generalisability (Yin 1994, Smith 1991, Bryman 1988, 1989). Since qualitative research shares the same problem (Miles and Huberman 1994, Bryman 1988, 1989) and this research uses case studies in which large amounts of qualitative data is gathered, the following discussion is based on arguments relating to both case studies and qualitative research. Researchers (Yin 1994, Smith 1991, Bryman 1988, 1989, Maxwell 1992, 1996) counter-argue against critics regarding the low generalisability of case studies and qualitative research. For instance, Yin (1994) comments that criticisms on the grounds of low generalisability are implicitly constructed from survey research, in which a sample is used to readily generalise a larger universe. This analogy to samples and universes is incorrect when dealing with case studies because survey research relies on statistical generalisation, whereas case studies rely on analytical generalisation. In analytical generalisation, the investigator is striving to generalise a particular set of results in relation to some broader theory.

Therefore, applying the sampling logic of the survey to the case study is misleading (Yin 1994, Smith 1991). Generalisation of case studies is achieved by building theory (Smith 1991) or building theoretical insights (Bryman 1989).

However, it is noted that the use of a single case study is a weak method of forming generalisations, as there is difficulty in avoiding the criticism that the case sample is a unique or exceptional case within the population. Furthermore, as all organisations have unique contingencies to some degree, multiple case studies can capture the variation of practices within the population and increase generalisability by testing the same issues on multiple cases. This logic is the same as for multiple experiments (Yin 1994, Jankowicz 1995, Miles and Huberman 1994). Hence, multiple case studies in Japan and the UK are conducted in this research.

Whilst the results of case studies can be generalised through analytical generalisation or theory building, few researchers deny the usefulness of surveys to strengthen generalisations and to facilitate understanding. Surveys can capture the general situation of payment systems due to the extensive nature of the method (descriptive surveys). Ideally, conducting both case studies (intensive research) and surveys (extensive research) is desirable because the triangulation of multiple methods can increase the validity of results (Gill and Johnson 1997, Denzin 1989). However, this research cannot expect a high level of validity, even if large scale surveys are conducted as the primary data gathering method, due to resource constraints. For example, interview surveys can increase validity in several areas such as increasing response rates and decreasing misunderstanding of survey questionnaires (Bryman 1988, 1989, Maxwell 1996, Millward et al. 1998), but these cannot be conducted because of resource constraints. Therefore, case studies are selected as the most suitable method, with extensive secondary survey data being utilised to support the analysis. The high transparency of surveys can increase the quality of secondary data analysis (Marginson 1998, Millward et al. 1998).

5.4.2 Theoretical criteria for selection of case study firms

As generalisation in case studies (and qualitative research) is achieved through analytical generalisation or theory building, the selection of case firms should be analytical or theory-driven (Miles and Huberman 1994). Researchers (Glaser and

Strauss 1967, Maxwell 1996, Yin 1994) provide some concrete approaches for the selection of case studies. Glaser and Strauss (1967) discuss theoretical sampling, whereby samples must be chosen according to theoretical criteria. Theoretical sampling is undertaken in order to discover categories and properties and to suggest their interrelationships via theory. In theoretical sampling, categories are “concepts that stand for phenomena” (Strauss and Corbin 1998:101p) and properties are “characteristics of a category, the delineation of which defines and gives it meaning” (Strauss and Corbin 1998:101p). Yin (1994) argues for ‘replication logic’. Generalisation is achieved by replication of the results from literal replication cases which predict similar results, and theoretical replication cases which produce contrasting results but for predictable reasons. Therefore, the careful selection of cases to provide both predicted literal replication and predicted theoretical replication could enable generalisation of the results.

This research firstly uses the replication logic proposed (Yin 1994) for selecting the case firms and these firms are then tested by theoretical sampling (Glaser and Strauss 1967, Strauss and Corbin 1998). Testing with two types of theoretical criteria may be the same as attempting triangulation. One of the purposes of triangulation is “to use different research methods in the same study to collect data so as to check the validity of any findings” (Gill and Johnson 1997:178p). The same logic is applied to the selection of the case firms. That is, using two types of sampling logic can increase external validity.

The first approach is choice by criterion from literal and theoretical samplings as argued by Yin (1994). Amongst the four conditions set for selecting the case firms in section 5.2, the industrial sector has aspects of both literal replication and theoretical replication. The literal replication cases are case studies within the same industrial sectors, and the theoretical replication cases are case studies in different industrial sectors. The ideal situation would be two case studies in each of the selected five industrial sectors. But this could not be achieved in this research. The number of case firms in each industrial sector is indicated in table 5-1.

Table 5-1: Number of case firms in each industrial sector

Industrial sector	Japan	UK
Telecom	2	2
Food and drink	2	3
Chemical and pharmaceutical	2	1
Retail	2	1
Oil	1	1

Notes: Company JT3 in the telecom industry (the UK-owned firm in Japan) is excluded from table 5-1.

A limitation on the research is the fact that there is a single case study in one industry (oil) in Japan and three industries (chemical and pharmaceutical, retail and oil) in the UK. However, this limitation may not be critical, because as multiple case studies are achieved in two industrial sectors, the telecom industry and the food and drink industry, literal replication is achieved in these two industries. Therefore, both literal replication and theoretical replication are achieved.

The next step is the examination of the case firms by theoretical sampling - the examination of whether the case firms in each country sufficiently satisfy the categories and properties of each payment system. Only the main categories and properties are examined as conditions of theoretical sampling. Because the payment system is very complicated, if all categories and properties were examined, the list would be endless. Categories examined here are the job, the market and the person, which the author identifies as the basic factors in the construction of payment systems. This examination is summarised in table 5-2.

Table 5-2: Examination of the case firms by theoretical sampling

Japan

(1) Job category
General situation
Job- or role-related pay – 43.9% for managers, 24.9% for non-managers (JPCSED 2001)
Case firms
Person-related pay – 4 firms for managers, 5 firms for non-managers
Job- or role-related pay – 5 firms for managers, 4 firms for non-managers
(2) Market category
General situation – there is no survey about use of market pay for jobs

Case firms
Participation in market salary survey – 3 firms (2 firms participating with small numbers of the employees)
Use of pay data in the industrial sector – 2 firms
(3) Person category
(3-1) Output-based (subcategory of person category)
General situation
Link MBO with pay – 79.9% (Sanno University 2000)
Case firms
Link MBO with pay – 7 firms
(3-2) Input-based (subcategory of person category)
General situation
Competencies are considered in relation to pay – 11.2% (JPCSED 2001)
Case firms
Competencies are considered in relation to pay – 7 firms

Notes: The case of the UK-owned firm in Japan (Company JT3) is excluded.

UK

(1) Job category
(1-1) Job evaluation (subcategory of job category)
General situation
Point factor – 66% (Industrial society 1996)
Point factor – 59%, Market-based – 51% (Towers Perrin 1997)
Job ranking – 46%, Point factor – 36% (Towers Perrin 2000)
Case firms
Point factor – 2 firms
Job ranking/job classification and market-based – 6 firms
(1-2) Pay structure (subcategory of job category)
General situation
Broadbanding is the most common structure (CIPD 1999)
Case firms
No pay bands corresponding to jobs – 2 firms
Broadly and loosely banding pay structure – 4 firms
Broadbanding pay structure – 1 firm
Traditional grade structure – 1 firm
(2) Market category
General situation
Use of market pay – 45.6% (IRS 2000), 72% (Towers Perrin 1997)

Case firms All firms use market pay External relativity is first (market pay), internal relativity is second – 6 firms Internal relativity is first, external relativity complements this – 2 firms
(3) Person category
(3-1) Output-based (subcategory of person category)
General situation Use of IPRP (individual performance related pay) – 60.5% (IRS 2000)
Case firms All case firms use IPRP for employees targeted by this research
(3-2) Input-based (subcategory of person category)
General situation Use of competency pay – somewhere between 10% and 30%
Case firms 7 firms use competency profiles in performance reviews, but whether competencies are actually assessed and whether they are related to pay reviews is not consistent across the firms.

Notes: One case firm (Company BR1) was in the process of change at the time of the research in 2000.

As described in table 5-2, the case firms in both Japan and the UK cover the properties of all the categories. Although there are minor differences in the characteristics of the properties between the general situation and case firms' practices, such as the use of market pay and competency pay, the differences may not be critical. This is firstly because all properties are covered, which is the most important criterion. The second is that the case firms are more likely to introduce state-of-art techniques. The main difference between the general situation and case firms lies in this property. For instance, competency pay, especially in the Japanese case firms, is more widespread than in the general situation in Japan. Therefore, the use of new techniques can be uncovered in the case firms. At the very least, firms using new trends are better suited for case study subjects than firms using 'out-of-date' systems.

5.5 Data gathering

This section summarises the organisational level studied, the areas from which the data is to be gathered, the data gathering method for the case firms, and information sources other than these case firms.

5.5.1 Organisation level of payment systems studied

Firstly, it is necessary to clarify the target levels of payment systems in the case firms. The basic question was whether the corporate level or divisional level of the case firms should be studied. Where one payment system is basically applied to all full-time and permanent employees, the payment system is studied at the corporate level. However, where there are more than two payment systems operating in a case firm, the payment system is studied at the divisional level. The reason for studying one payment system is that these systems are very complicated, and large amounts of information and detailed analysis are needed in order to achieve the research objective. If the research targeted many types of payment systems operating in the case firms, the amount of information and the quality of analysis of each payment system would be decreased.

In all the Japanese case firms, the same payment system was applied to all employees, although there were minor differences. Therefore, payment systems were examined at corporate level for all the Japanese case firms. In the UK, payment systems were studied at corporate level in two case firms and at divisional level in six case firms. There are two criteria for choosing one system from the various payment systems operating at these case firms. One is that it should be the system which applies to the largest number of employees. The other is that it should be an important payment system, according to the research objectives. The concrete criterion for judging the 'important payment system' used in the six UK firms will be discussed in chapter 7. It is noted that even though the divisional level of the payment system is studied, the whole structure of the payment system in the case firms is also studied in order to provide context.

5.5.2 Data gathering areas

The information needed to answer the research questions shall be clarified here. The research questions are divided into three types -- 'why', 'what' and 'how' questions.

1) 'Why' questions are concerned with 'why payment systems change or do not change'. In order to answer this, information is needed on the following areas:

a) External and internal environments surrounding payment systems

External and internal environmental factors are exemplified in table 4-1 in chapter 4.

There are two types of information sources for environmental factors. One is relatively objective information published or analysed outside the case firms. The other is information from the case firms' perspective. The main information providers inside the case firms are the HR practitioners. Employees other than those from the HR function also provide their perspectives on their payment systems, as employee reactions and perspectives are also considered as one of the environmental factors.

b) Objectives of payment systems in relation to overall organisation and HRM strategies

c) Why the case firms are changing their payment systems (if they are changing them)

Information about b) and c) is gathered from the HR practitioners in the case firms.

A variety of external and internal factors influence payment systems. Environmental factors that potentially influence payment systems are listed in table 4-1. An important question relates to how this research should examine the factors that influence payment systems in the case firms. It is noted case firms may or may not recognise the influence of factors. Low context/contingency factors are most likely to be recognised and high context/institutional factors least. Institutionalists (Scott 1998, DiMaggio and Powell 1991) emphasise cognitive processes whereby once people are habituated to particular social factors, they are unlikely to clearly recognise the characteristics of these factors or why they were formed. The research often found that this assumption by institutionalists held true in the case firms. Case firms often did not recognise these characteristics and why these characteristics were formed.

The approach to factors in which the case firms realise the influence is relatively straightforward - gathering information from the case firms through the analysis of internal documents and interviews.

There are three main approaches to the influential factors that remain undetected by case firm respondents. The first is through comparison between the case firms in Japan and the UK. As will be described in the next section, the research process is 'UK firms → Japanese firms → UK firms → Japanese firms'⁵⁰. This research adopts a two step

⁵⁰ If supplementary research in the first and second steps of the research is included, the research step is 'UK firms → Japanese firms → UK firms → Japanese firms → UK firms →

research design for the case firms in Japan and the UK as will be discussed later. In the second step of the research, the case firms in both countries are examined on the basis of the information gathered in the first step. Therefore, the case firms can be asked questions based on information gathered from the case firms in the counterpart country. The research can approach the influential factors that remain undetected by the case firms using these multiple steps.

The second approach is to study the UK-owned firm (Company JT3) in Japan. Japanese HR practitioners in this firm may understand the HRM practice in both Japan and the UK through direct experience as described above.

The third approach is investigation based on the review of literature about the characteristics of social institutions and business systems in the two countries. This approach is based on the framework of institutional theory and the characteristics of proximate social institutions and business systems in Japan and the UK as described in section 4.5 in chapter 4.

Information published outside of the case firms is also used to help understand environmental factors that are both recognised and unrecognised by the case firms.

2) The ‘what’ question concerns ‘what aspects and to what extent payment systems change or do not change’. Information needed to answer the question is divided into three areas:

- a) The current content of payment systems
- b) The past content of payment systems (where the systems recently changed or are now changing)
- c) Contents of planned change (where the case firms have a concrete plan for future change)

Information about a), b) and c) was gathered from the HR practitioners in the case firms. Although the research focuses on base-pay, information on other financial rewards such as cash based profit sharing and share ownership schemes in the UK case firms, *shoyo* (biannual regular bonus) and *taishokukin* (turnover money) in the Japanese case firms, and employee benefits in both the UK and Japanese case firms, were gathered from the case firms in order to develop a complete picture of financial rewards. Areas covered by

payment systems and other financial rewards are listed in Appendix I.

3) The 'how' question concerns details of the payment systems and individual pay review processes. The main information provider regarding payment systems is the HR practitioners. Regarding the individual pay review processes, there are two types of information sources. One is the HR practitioners, on issues such as guidelines about details of the processes, and information on individual pay review processes which is gathered by the HR practitioners. The HR practitioners include a pay designer in the head office⁵¹ and pay implementers at divisional level. The other is employees outside HR function (line managers and non-managers), who discussed their own pay review process. The employee interviews cover their perspectives on their payment systems. The questionnaire for employee interviewees can be found at Appendix II.

5.5.3 Data gathering methods

Documentary analysis and interviews are the research methods used to gather information on the case firms.

1) Documentary analysis

The main documents used in the documentary analysis are internal documents provided by the case firms. The areas covered by these internal documents are listed in Appendix III. Published documents by the case firms such as organisation strategy and financial information, and reports or articles published outside the case firms, are used as supplementary data.

2) Interview

a) Interviewees

HR practitioners

The main interviewees are HR practitioners. The areas covered by the interviewees are the same areas as the research areas for the 'why', 'what' and 'how' questions. HR practitioners are categorised by organisational level (senior manager, middle manager and junior manager/professional level) and by function (pay designers in head office and pay implementers at divisional level). Amongst the pay designers, the content of the

⁵¹ In the six case firms in the UK, payment systems at the division level are researched. However, head office designs the targeted divisional level payment systems.

interviews differs by organisational level. That is, senior and/or middle managers tended to be asked about strategic aspects, and middle managers and/or junior managers/professionals tended to be asked about detailed content and operational aspects. However, there was no strict division in the content of the interviews.

The purpose of the interviews for pay implementers is to learn about the individual pay review processes in the real setting. As the divisional HR (pay implementer = divisional HR) has a closer proximity to pay reviews in the real setting than the corporate HR department, they must have greater knowledge about the operation of individual pay reviews. Therefore, the interviews for the divisional HR include areas such as the processes of individual pay reviews and appraisals, perceptions of employees in the payment system, and the coordination by the divisional HR of appraisal ratings and pay reviews decided by line managers. However, the questionnaires for the divisional HR were not prepared so that they could adjust to each situation. The number of interviewees in the HR departments in each category is indicated in table 5-3.

Table 5-3: Number of interviewees in HR function

Japanese case firms		UK case firms	
Pay designer	29	Pay designer	23
Senior HR manager	9	Senior HR manager	3
Middle HR manager	17	Middle HR manager	14
Professional or junior HR manager	3	Professional/junior HR Manager	6
Pay implementer	4	Pay implementer	2

Notes: Senior HR manager = Head of HR function at corporate level or divisional level (in Japanese case firms they are board members).

Middle HR manager = HR line managers who have responsibility for pay and other HR areas report directly to the head of the HR function.

Professional or junior HR manager = below middle HR manager level

All pay implementers interviewed in the Japanese case firms are middle managers.

All pay implementers interviewed in the UK case firms are professional level.

Employee interviewees (line managers and non-line managers)

There were two purposes of interviews with employees. The first was the capturing of the actual individual pay review process. The HR sets guidelines on pay reviews, however, actual pay review practices do not necessarily follow the guidelines. Interviews with employees help reveal the actual processes. Furthermore, the detailed processes of how pay levels are determined and the focal points for pay reviews in the

real setting can be found through the interviews. The second was to understand the perception of employees about their payment systems. The research approaches payment systems through investigation of their relationships to environmental factors. Employee perception is one of the environmental factors. Employees (line managers and non-line managers) were interviewed in seven firms (four firms in Japan and three firms in the UK), but not in all the case firms. The reason for this number will be indicated in the next section. The interview questionnaire is provided in Appendix II. The number of interviewees is shown in table 5-4.

Table 5-4: Number of employee interviewees

Japanese case firm		UK case firm	
Line manager	18	Line manager	10
Non-line manager	9	Non-line manager	5

b) Interview method

The interview method is divided into three (structured interview, semi-structured interview and unstructured interview). Structured interviews use questionnaires based on a predetermined and standardized sets of questions. In semi-structured interviews, the researchers have a list of themes and questions to be covered. However, the questions asked and the order of questions may vary from interview to interview. Unstructured interviews have no pre-determined list of questions, although a clear idea about issues being explored is required. Among the three interview methods, the semi-structured interview and unstructured interview enable the elucidation of not only 'what' but also 'why' and 'how' (Saunders et al. 1997, 2000, Jankowicz 1995, Easterby-Smith et al. 1991).

The interviews for pay designers (corporate HR) used semi-structured and unstructured interviews. Semi-structured interviews tended to be used in the early stages of the research and unstructured interviews tended to be used in the later stages. As the interviews were often conducted several times for corporate HR in individual case firms, the interviews in the later stages were more likely to concern details and processes, the perspective of HR practitioners of the external and internal environments surrounding their HRM, and the perspective and intention of policies for the HRM and pay area. Therefore, the interviews in the later stages tended to be more unstructured. In the early stages, as all areas where information was needed had to be covered, the interviews

were more likely to be semi-structured. The interviews for pay implementers tended to be unstructured, since the author adjusted the questions to the situation of each individual interviewee. Interviews for employees were semi-structured, since they had to cover all necessary areas in order to capture the pay review processes and perspectives of the payment systems. However, in reality, the interviews for employees did not always cover all questions due to time constraints.

5.5.4 Information from sources other than case study firms

Information on the general HRM situation and the HRM situation in the case firms was gathered from outside of the case firms as supplementary information. Subject areas of the information and methods of information collection can be largely divided into three types. The first is interviews with consulting firms who conduct market salary surveys. Five consultancy firms were interviewed. Three were in Japan and two in the UK. All five firms are multinational consulting firms who conduct market salary surveys on a global scale. Two of the Japanese and two of the UK consultancy firms are subsidiaries of the same two consultancy firms. The contents of the interviews included the general situation of HRM and pay in both Japan and the UK, and the situation with market salary surveys and how to conduct them. Materials were provided from the consultancy firms such as job descriptions used to gather the data and the format for gathering the data. The second method is interviews, including informal communication on the general HRM situation in Japan with Japanese HRM specialists (practitioners, consultants and academic researchers). The third involved personal correspondence regarding the overall situation, including organisation and HRM strategies, in the case firms in Japan. As Japanese case firms were approached through the JMA (Japan Management Association), the author asked members of the JMA about key practitioners in HR function, and organisation and HRM strategies in the case firms.

5.6 Research processes

Ten firms in Japan (one is UK-owned) and eight firms in the UK were studied. This section summarises the methods of access, and the processes and schedule of the research.

5.6.1 Access to case study firms

The initial approaches to the case firms in the UK and Japan were between June and October 2000. Methods of contacting the firms differed between Japan and the UK. In the case firms in Japan, eight out of ten firms were accessed through the JMA where the author worked. Members of the JMA explained the research objective based on a request letter written by the author and asked for participation in the research from potential case firms. As a result, eight firms agreed to participate. Another case firm (Company JC2) agreed to participate after informal communication between the head of the HR function (board member), the HR director (head of HRM system planning) and the author. Another case firm (Company JT3, the UK-owned telecom firm) participated in the research by introduction from the UK parent firm (one of the case firms in the UK). For the UK case firms, request letters were directly sent to the potential case firms (to the head of the HR function), because the author's relationship with the body corresponding to the JMA in Japan was not as well established. As a result, eight firms agreed to participate in the research.

5.6.2 Further research processes

1) First step – July to September 2000 for the UK case firms, September to October 2000 for the Japanese case firms.

In the first step of the research, HRM (the main topic was payment systems, but other HRM areas were also explored) and related issues such as external environments and organisation strategy were explored. Other topics discussed in the meetings included an explanation of the research objective and future research, and internal documents that the author wished to gather. There were one or two meetings in the first step. The length varied from two hours to five hours (excluding lunch). The number of meeting participants varied between one and three, and the volume of internal documents provided in the first step also varied between the firms.

2) The two-step research adopted for this thesis

The author decided to conduct further research into wider areas related to payment systems with more detailed information from a smaller number of the case firms. Generalisability was already established in the first step of the research, and so the purpose of further research was to increase construct or internal validity. A smaller

number would be sufficient for this further research. Moreover, there should be a trade-off between the amount of information from each case firm and the number of the case firms. Where the number of case firms increases, the amount of information gathered from each case firm can decrease, if the resources remain the same. This further research is referred to as second step research.

While generalisation was achieved in the first step of the research through the achievement of two sampling logics for analytical generalisation as discussed in section 5.4.2, the establishment of analytical generalisation for second step research is also desirable. The criteria used for selecting the case firms for the second step research consisted of the same two logics -- replication logic and theoretical sampling. Concerning replication logic, a total of four firms on either side were chosen as the case firms, two firms in the telecom industry, and food and drink industry in both Japan and the UK. Regarding theoretical sampling, the type of job evaluation used -- analytical job evaluation or non-analytical job evaluation -- was used as a criterion of dimension on the UK side. On the Japanese side, whether job-related pay or person-related pay was used as a criterion of dimension. The definition of dimension in theoretical sampling is "the range along with general properties of a category varies, giving specification to a category and variation to the theory" (Strauss and Corbin 1998:101p). As a result, the following four case firms were chosen.

UK firms: Company BT1 (telecom industry and non-analytical job evaluation), Company BT2 (telecom industry and non-analytical job evaluation), Company BF1 (food and drink industry and non-analytical job evaluation), and Company BF 3 (food and drink industry and analytical job evaluation).

Japanese firms: Company JT1 (telecom industry and person-related pay), Company JT2 (telecom industry and person-related pay), Company JF1 (food and drink industry and role-related pay), and Company JF2 (food and drink industry and person-related pay).

In addition, Company JR1 was added which used job-related pay. This is because although Company JF1 has implemented role-related pay, the role definition in Company JF1 is very brief.

The research design is divided into two steps and wider areas and more detailed information was gathered in the second step. However, in practice, there was little strict division between the first and second steps of the research in terms of the areas and amounts of information. For instance, one division between the first and second steps

may be whether employee interviews (for line managers and non line managers) are conducted, but for one case firm in the UK (Company BR1), the author had already interviewed two employees in the first step of the research. The amounts of internal documents provided in the first step also differed. For instance, Company BF2 provided large amounts of internal documentation in the first step. Therefore, the division of the first step and second step is a rough estimation rather than a strict division. The reason why the second step of the research was conducted for a smaller number of the case firms was that the author judged the total amount of information gained in the first step of the research as being insufficient.

3) Supplementary research in the first step – November to December 2000 for the UK case firms in the UK and April to May 2001 for Japanese case firms

While the author planned to separate the research into the first and second steps, the author also thought that information should be gathered from all case firms beyond a certain level which included objectives and the main contents of payment systems, in order to capture the whole picture of these systems in all of the case firms. Accordingly, supplementary meetings were conducted with four of the case firms in the UK (Company BT1, Company BT2, Company BF2 and Company BR1) and four case firms in Japan (Company JT1, Company JF2, Company JC2 and Company JO1).

4) The second step of the research – July 2001 to January 2002 for the UK case firms and January to April 2002 for the Japanese case firms

The second step of the research was conducted in three case firms in the UK (Company BT1, Company BT2 and Company BF1) and five case firms in Japan (Company JT1, Company JT2, Company JF1, Company JF2 and Company JR1). On the UK side, Company BF3 was included as a subject in the second step in the initial plan. However, Company BF3 refused to participate in further research. This was because the firm was being restructured. The financial situation of the firm was very bad mainly due to the outbreak of foot and mouth disease at the time⁵². The author decided to conduct the research with the three firms in the UK, and not to approach other firms for the following reasons. The first is that the total amount of information gathered from the UK firms was sufficient. Secondly, analytical generalisation had already been achieved by replication logic and theoretical sampling in the first step.

⁵² There are other reasons. For example, Company BF3 divested its distribution business which had a good financial result mainly due to demands of the shareholders just before the occurrence of foot and mouth disease.

5) Supplementary research in the second step – July 2002

After finishing the second step research for the Japanese case firms, supplementary research for two UK case firms (Company BT1 and Company BT2) was conducted.

5.6.3 Amounts of information gathered

The amounts of information gathered from individual case firms varied. Company JT1, Company JF1 (Japanese side), Company BT1 and Company BT2 (UK side) provided the most comprehensive information. For example, these four firms provided opportunities for employee interviews (with both line managers and non-line managers). Interviews of line managers illustrate many differences and clear contrasts between the two countries in several areas. For example, UK line managers put more emphasis on people management when discussing their main responsibilities. UK line managers often pointed out that they have two main responsibility areas; one is for business success using their professional knowledge and skill for their business areas, and the other is business success through people management. On the other hand, no line managers in Japanese case firms pointed out people management as their main responsibility. Furthermore, line managers in the UK look for granted their responsibility for determining individual pay levels, whereas in Japan it was taken-for-granted that this was the responsibility of the HR function. These four firms also provided many types of internal documents that show operations of payment systems in detail. These documents also included strategic level information on how they perceive their external environments, analysis of their internal situations, organisation strategies, and HR and reward policies to achieve their organisation strategies. In particular, Company BT2 offered the author direct access to its internal computer network at the corporate and HR function levels. The author accessed the LAN to obtain information herself. This opportunity enabled the author to gather a huge amount of information.

Large amounts of internal documents gathered from the four firms allowed the author to understand and describe their payment systems in terms of why they chose particular types of payment systems and how these payment systems are operated. Moreover, interviews of several HR practitioners revealed many aspects of reward policy. For example, the author interviewed three levels of HR practitioners dealing with reward

policy in Company JF1 and Company BT2. These were the head of HR (board member), a director dealing with reward policies and specialist managers dealing with reward policy for Company JF1, and the head of HR in the global business division⁵³, directors dealing with reward policies and professionals dealing with reward policies in Company BT2. These interviewees at different organisational levels gave the author a broad view of how HR policy should help to achieve organisational strategy and also to focus on more operational aspects of individual pay determination. For example, a specialist in Company BT2 who deals with market pay surveys explained how jobs and pay are matched from market pay data based on data from several market salary surveys in which Company BT2 participates. The specialist manager who deals with reward policies in Company JF1 explained details of current changes in base-pay and many types of *teate* (allowance) using examples of model cases about how the change affects each employee. He had conducted a simulation using many types of model cases. Furthermore, divisional HR explained a vivid picture of the operation of individual pay determination. For example, the divisional HR in Company JT1 explained his calculation to execute forced distribution. His detailed explanation expressed the strength of the coordinating function of HR in Company JT1.

Company JF2, Company JR1 and Company JR2 on the Japanese side, and Company BF1, Company BF2 and Company BR1 on the UK side also provided large amounts of information. For example, the author interviewed five line managers (head of sales branches) and five non-line managers (sales persons of these sales branches) in Company JF2. This combination increased the author's level of understanding in many areas, such as how each line manager and non-line manager perceived the business situation of their own branch, the perception of task allocation to each member of their branch by the head of the branch, how the daily business and *houshin kanri* (management principle)⁵⁴ are related and how the daily business and appraisal are related.

For Company BF1, the author researched the process of change of HR policy including

⁵³ Company BT2 largely divides its corporate structure into two divisions; one is the global business division dealing with three main regional areas in the world (North America, Europe and Japan) and the regional business division dealing with other regional areas in the world.

⁵⁴ *Houshin Kanri* is a management method used to deal with performance in the daily business or operation about how a firm's and/or division's performance targets are achieved. *Houshin kanri* is widespread in operation management in Japanese firms, including the case firms. *Houshin kanri* is a separate function from the HR function of *jinji kouka* (appraisal).

reward areas. This change was conducted to achieve a new organisational strategy created by a new CEO. HR practitioners dealing with reward (three levels as head of reward policy, managers of reward policy and professional level of reward policy) explained the reasons, content and process of reward change in detail. Internal documentation of 'Audit on Reward Change' expressed the organisational process of the change and how employees, including line managers, reacted to the change in Company BF1. The information gave the author an insight into the intentions of the new reward policy and the operational difficulty in achieving the new policy throughout the organisation.

The author judged the amounts of information provided by HR function to be sufficient on both the Japanese and the UK sides. There were no new things emerging in the research of the HR in the latter stages. That is, the research on the HR had reached theoretical saturation, which is the point in category development at which no new properties, dimensions or relationships emerge during analysis (Glaser and Strauss 1967, Strauss and Corbin 1998). For example, the case studies gathered information about what elements and how these elements constitute base-pay. The 'how' aspect includes the performance management cycle and contents of the performance review in the UK case firms, and MBO cycles and contents of each appraisal in Japanese case firms (Japanese case firms except Company JT3 operate more than two types of appraisal relating to pay as will be described in chapter 6). Furthermore, as base-pay often consists of some independent units (as *heizongata chingin* explained in section 3.3.1 in chapter 3) in Japanese case firms, the author gathered information about the contents of each independent unit, on elements that determine each independent unit and how elements determine amounts of pay of each unit. The author analysed the payment system of each case firm and compared case firms between the UK and Japan based on the information gathered from the case firms.

Employee interviews (with line managers and non-line managers) were conducted in four firms in Japan (Company JT1, Company JF1, Company JF2 and Company JR1) and three firms in the UK (Company BT1, Company BT2 and Company BR1). In terms of employee interviews, the author confirmed that the conditions for theoretical saturation had been surpassed many times for the Japanese cases, but could not confirm the same for the UK cases due to a smaller number of interviews. One of the reasons for the small number in the UK cases was that Company BF1 suddenly refused permission

for employee interviews despite their previous agreement. The reason for this was the change of head of the HR function in the company. The new head of the HR function refused further involvement in the research. As a result, the same levels of theoretical saturation could not be achieved on the UK side as on the Japanese side.

One method of increasing the level of theoretical saturation was to conduct employee interviews in another firm. However, the author did not feel there was sufficient justification to consider this a necessity. There are mainly three reasons for this decision. The first is that information from the employee interviews covers only some of the research areas – the processes of individual pay reviews and the perspective of employees on their payment systems. The main information source is the HR practitioners -- not line managers and non-line managers. The second is that the amount of information from employee interviews on the UK side nearly reached theoretical saturation. The only problem was that the author could not confirm full achievement of theoretical saturation on the UK side, unlike the Japanese side. Hence, the problem is not critical. The third is that the purpose of the employee interviews in the UK case firms was to compare individual pay review practices and perceptions on pay and payment systems. The author judged that the employee interviews from the Japanese and UK case firms sufficiently revealed differences between the two sides including differences in taken-for-granted aspects. Therefore, the purpose of employee interviews was achieved. The most important point is the third point among the three points due to achievement of the purpose.

It can be said that this research achieved a high level of internal and external validity. Although the research does not achieve them perfectly, there is no research that achieves perfect internal and external validity. Table 5-5 indicates the timetable of research and feedback within the case firms. The author was feeding back research findings and related issues to the case firms in both the UK and Japan on several occasions.

Table 5-5: Research schedule and feedback to case firms

Research step and feedback	Time
First step of the research in the UK case firms – one or two meetings with each firm	July to September 2000
First step of the research in the Japanese case firms – one meeting with each firm	September to October 2000
Supplementary research for first step in the UK case firms	November to December 2000
Supplementary research for first step in the Japanese case firms (provision of feedback report about findings of the first step of the research/Japanese version)	April to May 2001
Second step of the research in the UK case firms (provision of feedback report about findings of first step of the research + report on ‘Characteristics of HRM in Japan’ – literature review on Japanese HRM)	July 2001 to January 2002
Second step of the research in the Japanese case firms (provision of feedback report about findings of first and second steps of the research for the UK case firms/Japanese version)	January to April 2002
Provision of feedback report on ‘General Practices on Market-Related Pay in the UK’ (written in Japanese) which was developed based on literature review and case studies of the UK case firms	June 2002
Supplementary research of second step of the research for the UK case firms (provision of feedback report on ‘Characteristics of Payment Systems in Japan’ – literature review on Japanese payment systems)	July 2002
Provision of final feedback report to all case firms -- English version for the UK case firms and Japanese version for the Japanese case firms	September to October 2003

5.7 Summary

This chapter firstly identified case studies as the primary data gathering method, because the case study can capture a more holistic picture than any other research method through the intensive study of a small number of case firms. In addition, the

chapter discussed the problem of generalisability from case studies and how the problem is overcome. As a result, the author decided to use two sampling logics of analytical generalisation-- replication logic and theoretical sampling - for selecting the case firms in Japan and the UK, in order to increase generalisability of the research findings.

This chapter also discussed other conditions used to select case firms in order to decrease extraneous variables and increase internal validity. In the final part of this chapter, details of the research were described, such as areas, methods and processes for gathering data from the case firms. The next two chapters describe payment systems in the case firms based on the data gathered through the case studies.

Chapter 6: Description of payment systems in case study firms in Japan

This chapter and the next chapter looks at payment systems in Japan and the UK using information from case studies, and chapter 8 compares payment systems between case firms in the two countries. The thesis limits descriptions for payment systems and other related issues such as the business situation in the case firms up to the time the case studies were conducted. Therefore, for example, business situations after the case studies were conducted are out of the scope of this thesis.

Before the payment systems in the case firms are described, we need to address why the focus shifts from a conceptual framework towards case studies. That is to say, whilst the conceptual framework of relationships between environmental factors and payment systems on what, how and why environmental factors influence payment systems was developed in chapter 4, and potential influential environmental factors were identified as indicated in table 4-1 in chapter 4, a case-informed explanation of payment systems patterns and trends and the reasons for these in Japan and the UK is needed.

The conceptual framework in chapter 4 is developed through a theory driven, deductive approach. However, the deductive approach has the serious problem of not being able to gather information that the researcher has no knowledge of prior to the research (Miles and Huberman 1994, Gill and Johnson 1997, Yin 1994). One of the objectives of this research is to investigate how and why payment systems are changing as a result of 'strategic decisions' (Child 1972) in individual firms as discussed in chapter 1. Therefore, gathering information that the author had no knowledge prior to the research from individual firms is inevitable to achieve the research objective. Case studies include both deductive aspects (justification of causal relationships or hypothesis testing, including aspects of why and how based on large amounts of detailed information from case subjects) and inductive aspects (exploring and understanding situations of case subjects through gathering large amounts of detailed information from case subjects). Therefore, emphasis should be shifted from a conceptual framework towards a case-informed explanation, although the author has the conceptual framework in mind during the case studies. The conceptual framework (deductive approach) and gathering information through case studies (that includes an inductive approach) can be practically compatible with each other, because no researcher starts his/her research with no idea prior to the research. In a practical sense, all researchers have some ideas

or information about the subject prior to the research even though they choose the inductive research method (Miles and Huberman 1994).

6.1 Profiles of case study firms

Ten firms were studied in Japan. Company JT3 is a subsidiary of the UK-owned firm (UK case firm) taken over in 1999. This chapter describes the characteristics of the payment system in the case firms in Japan. Changing aspects are particularly focused, as all case firms recently changed their payment systems. Firstly, profiles of the case firms are listed in table 6-1.

Table 6-1: Profiles of case firms in Japan

Case firm	Profile
Company JT1	Third ranked telecom firm in Japan covering the full-line of telecom network services. Established in 1984 based on the former national railway firm. In 2001, the UK mobile phone firm (UK case firm) acquired 70% of the shares of Company JT1. After taken over by the UK firm, company JT1 is undertaking business and organisational restructuring.
Company JT2	Top ranked mobile phone network provider in Japan and largest in the world by sales turnover. Established in 1992 as a group firm of the former monopoly. It has been rapidly growing along with the rapid expansion of the mobile phone market. However, the speed of market growth is decreasing in Japan.
Company JT3	Established in 1986 as an international telephone firm. In 1999, the UK telecom firm (UK case firm) took over Company JT3.
Company JF1	Second largest food processing firm in Japan. Company JF1 achieves good financial results. Its main problem is small scale compared with large MNCs.
Company JF2	Second largest drink firm in Japan. Company JF2 has the top position in Japanese beer market. Company JF2 faces strong cost competition from the other major beer manufacturers, and this has decreased profits. Deregulation of alcohol retailing has influenced the strategy of Company JF2.
Company JR1	Fifth ranked department store in Japan operating across the country. Company JR1 has serious financial problem due to huge amounts of debt generated by investment before the collapse of the bubble economy. Company JR1 is undertaking organisational restructuring including closure of several department stores.
Company JR2	Fifth ranked supermarket chain store mainly operating in the central part of

	Japan. Company JR2 has maintained a relatively good financial situation, while many retail firms have financial problems generated by debt from banks.
Company JC1	Top ranked pharmaceutical firm in Japan. Company JC1 has achieved good financial results. This attracts foreign investors. The problem is small scale compared with large MNCs. This problem has become serious due to the deregulation policy of the Japanese government.
Company JC2	Diversified into areas such as household products, cosmetics, food processing and industrial chemicals. Company JC2 has a differentiation strategy, continuously developing new value added products and services, and it continues to achieve good financial results. This attracts foreign investors.
Company JO1	Top ranked oil firm in Japan established by merger between the former largest oil firm and the sixth ranked oil firm in 1999. Industrial restructuring is undertaken in the oil industry in Japan due to the deregulation policy of the Japanese government. Company JO1 has made alliances with the third and fourth ranked oil firms in order to increase operating efficiency.

6.2 Elements of base-pay

6.2.1 Characteristics of elements of base-pay

The discussion starts with ‘elements of base-pay’ (*kihonkyu chingin taikēi*). First of all, the current situation concerning elements of base-pay is considered. Various aspects of this feature were found in the case firms. The first is that all case firms except Company JT3 divide elements of base-pay by employee levels (between managers and non-managers in many cases). One of the main divisions of elements of base-pay between managers and non-managers is whether age-related pay is included or not, as will be pointed out as the second point below.

The second concerns age-related pay. Elements of base-pay are largely divided into two types: one concerns elements that constitute base-pay as independent units within base-pay and the other concerns elements that influence individual pay levels but do not constitute independent units within base-pay. This difference is related to division of *heizongata chingin* and *tanitsugata chingin*⁵⁵. Seven case firms contain age-related pay

⁵⁵ Type of base-pay in Japan is largely divided into *tanitsugata chingin* and *heizongata chingin*

as an independent unit within the base-pay for non-managers or low level non-managers. No case firms contain age-related pay as an independent unit for managers. Further, nine firms except Company JO1 do not consider age and years of service for individual base-pay determination for managers. Concrete method that divides whether age and years of service is considered depends upon whether *jidou shoukyu* (automatic pay increase by age and years of service) is included in *teiki shoukyu* (regular pay increase)⁵⁶.

According to the case firm interviewees, one of the reasons why age-related pay is included only for non-managers or low level non-managers is that their pay levels are not necessarily sufficient to cover their cost-of-living. Age-related pay is used as pay to meet the cost-of-living. On the other hand, the pay levels of managers are sufficient to meet the cost-of-living. In all the case firms except Company JR1 and Company JR2, annual pay levels of employees at the managerial grade mostly exceed ¥10,000,000 (£55,555). The case firms consider this pay level to be sufficient to cover the cost-of-living.

Another main reason is that non-managers tend to be young under seniority-related promotion, which has been implemented for a long time. Therefore, non-managers are more likely to be at the development stage. In the young development stage, skills and knowledge (and other aspects such as attitude and behaviour) relating to their jobs are more likely to be developed according to years of service. As age is almost proportional to years of service under long term employment policy implemented by the case firms, age-related pay (*nenreikyu*) equates to years of service pay. Accordingly, all case firms consider that seniority-related pay increase has rationality to some degree for non-managers or low level non-managers. Use of age-related pay for non-managers or low level non-managers is one example that practices this idea. In contrast, managers tend to be old and middle aged, therefore, they are less likely to be at the development stage. Managers' skills and knowledge (and other aspects) relating to their jobs are less likely to be developed according to years of service any more. All case firms regard that manager's pay should not be related to seniority elements. Their pay levels should be more influenced by their contribution, especially their output performance, than that of

as discussed in 3.3.1 in chapter 3. *Tanitsugata chingin* and *heizongata chingin* are also described in Appendix IV.

⁵⁶ Content of *teiki shoukyu* (regular pay increase) is indicated in section 3.3.5 in chapter 3 and Appendix IV.

non-managers. This is the reason for the non-existence of age-related pay for managers. This reason is also applied to other aspects of payment systems and this issue will be indicated in relevant points.

Table 6-2 summarises the current situation of elements of base-pay regarding type of base-pay relating to *tanitsugata chingin* or *heizongata chingin* and elements of base-pay within the category of either *tanitsugata* or *heizongata chingin*.

Table 6-2: Elements of base-pay (*kihonkyu chingin taiki*) in case firms

Case firm	Type of base-pay (<i>tanitsugata</i> or <i>heizongata chingin</i>)	Elements of base-pay within category in either <i>tanitsugata</i> or <i>heizongata chingin</i>
Company JT1 Manager Non-manager	<i>Heizongata</i> <i>Tanitsugata</i>	Two types of job-related ability pay ¹ Job-related ability pay ¹
Company JT2 Manager Non-manager	<i>Tanitsugata</i> <i>Heizongata</i>	Job-related ability pay ¹ Job-related ability pay ¹ + age-related pay
Company JT3 All employees	<i>Tanitsugata</i>	Role-related pay ²
Company JF1 Manager Non-manager	<i>Tanitsugata</i> <i>Heizongata</i>	Role-related pay ² Role-related pay ² + age-related pay
Company JF2 Manager Non-manager ³	<i>Tanitsugata</i> (yearly salary system) <i>Heizongata</i>	Job-related ability pay ¹ Job-related ability pay + age-related pay
Company JR1 Senior manager Manager Staff	<i>Heizongata</i> (yearly salary system) <i>Heizongata</i> <i>Heizongata</i>	Job-related pay ² + Individual output performance-related pay ⁴ Two types of job-related pay ² Job-related ability pay ¹ + age-related pay
Company JR2 Senior manager Manager Staff	<i>Tanitsugata</i> (yearly salary system) <i>Tanitsugata</i> <i>Heizongata</i>	Role-related pay ² Role-related pay ² Job-related ability pay + age-related pay

Company JC1		
Manager	<i>Tanitsugata</i>	Job-related pay ²
Non-manager	<i>Heizongata</i>	Job-related pay ² + competency pay + age-related pay
Company JC2		
Senior manager	<i>Heizongata</i> (yearly salary system)	Role-related pay ² + individual output performance-related pay ⁴ + profit-related pay
Manager to staff	<i>Tanitsugata</i>	Role-related pay ²
Company JO1		
All employees	<i>Heizongata</i>	Job related ability pay + <i>Sougouky</i> ⁵

¹As competencies are linked to pay, type of pay can be categorised by competency pay. But name of 'job-related ability pay' (*shokunoukyu*) is used in the case firms.

² Name of pay in either job-related pay (*shokumukyu*) or role-related pay (*yakuwarikyu*) is according name used in each case firm. The case firms with job-related pay based on the formal job analysis and analytical job evaluation (point factor scheme) use name 'job-related pay' and case firms with job-related pay based on less formal job analysis and non-analytical job evaluation use name 'role-related pay'.

³ Company JF2 changed payment system to non-managers toward the same system of managers in 2003. But this thesis describes payment system when the case study was conducted (from 2000 to 2002).

⁴ *Gyousekiky* is expressed by 'individual output performance-related pay' in English. Other firms and other employee categories also include individual output performance-related pay, but they do not have independent units within base-pay or yearly salary.

⁵ Pay is determined by comprehensive judgment by consideration of factors such as age, years of service, academic background, job-related ability and output performance.

6.2.2 Change of elements of base-pay

Next is recent change in elements of base-pay. The change includes both change in elements of base-pay as independent units within base-pay and change in elements of base-pay that influence individual pay levels but do not constitute independent units within base-pay. Six directions are indicated as the main recent changes; abandonment and reduction of age-related pay, introduction of the job factor; introduction of yearly salary system, emphasis on results or output performance, introduction of competency pay and introduction of market factors. The reasons for the six directions are two fold: one is the increasing consistency between the current value or contribution⁵⁷ of employees and their pay levels. The other is the reduction of seniority elements of pay. As the case firms perceive that pay levels are seniority-related due to past pay increase practices, in order to realise consistency between the current contributions and pay, reduction of seniority elements is necessary. Table 6-3 summarises the year and contents

⁵⁷ The word 'contribution' is used when both output performance and input performance such as skill, knowledge and behaviour, are included as discussed in section 2.4.3 in chapter 2.

of recent change of elements of base-pay.

Table 6-3: Recent change of elements of base-pay in case firms

Case firm	Year of change	Contents of change
Company JT1		
Manager	1999	Job-related ability pay + age-related pay → job-related ability pay ¹
Non-manager	2000	Job-related ability pay + age-related pay → job-related ability pay ¹
Company JT2		
Manager	1997 –2000	Job-related ability pay including age-related element ² → job-related ability pay ¹
Non-manager	2001	Reduction of age-related pay
Company JT3		
All employees	2000	Job-related pay → role-related pay ³ Introduction of yearly salary system
Company JF1		
Manager	2000	Job-related ability pay including age-related element ² → role-related pay ³
Non-manager	2002	Job-related ability pay + age-related pay → role-related pay ³ + age-related pay (reduced)
Company JF2		
Manager	1998	Job-related ability pay + age-related pay → job-related ability pay ¹ Introduction of yearly salary system
Non-manager ⁴	1998	Reduction of age-related pay
Company JR1		
Senior manager	1995	Job-related ability pay + age-related pay → job-related pay ³ + individual output performance-related pay ⁵ Introduction of yearly salary system
Manager	1995	Job-related ability pay + age-related pay → job-related pay ³
Staff	1995	Reduction of age-related pay
Company JR2		
Senior manager	1998	Job-related ability pay + age-related pay → role-related pay ³ Introduction of yearly salary system
Manager	1988	Job-related ability pay + age-related pay → role-related pay ³

Staff	1998	Reduction of age-related pay
Company JC1		
Manager	1997	Job-related ability pay + age-related pay → job-related pay ³
Non-manager	1997	Job-related ability pay + age-related pay → job-related pay ³ + competency pay + age-related pay (reduced)
Company JC2		
Senior manager	1996	Job-related ability pay including age-related element ² → job-related ability pay Introduction of yearly salary system
	1999	Job-related ability pay → role-related pay + individual output performance-related pay ⁵ + profit-related pay
Manager to staff	1996	Job-related ability pay + age-related pay → job-related ability pay
	2000	Job-related ability pay → role-related pay ³
Company JO1		
All employees	1999	Reduction of age-related pay

¹ As competencies are linked to pay, type of pay can be categorised by competency pay. But name of 'job-related ability pay' (*shokunoukyu*) is used in the case firms.

² There is no independent unit of age-related pay, but age and years of service are accounted in individual pay review by *jidou shoukyu* (automatic pay increase by age and years of service) in *teiki shoukyu* (regular pay increase).

³ Name of pay in either job-related pay (*shokumukyu*) or role-related pay (*yakuwarikyu*) is according name used in each case firm. The case firms with job-related pay based on the formal job analysis and analytical job evaluation (point factor scheme) use name 'job-related pay' and case firms with job-related pay based on less formal job analysis and non-analytical job evaluation use name 'role-related pay'.

⁴ Company JF2 changed payment system to non-managers towards the same system of managers in 2003. But this thesis describes payment system when the case study was conducted (from 2000 to 2002).

⁵ *Gyousekikyū* is expressed by individual output performance-related pay in English. Other firms and other employee categories also include individual output performance-related pay, but they do not have independent units within base-pay or yearly salary.

(1) Abandonment and reduction of age-related pay

Age-related pay (*nenreikyu*) represents seniority-related pay, and abandonment and reduction of age-related pay is a direct method of reducing seniority-related pay. Instead of reducing seniority-related pay, appraisal-related pay has been increased. By applying this change, pay levels should become closer to the contribution levels assessed in the appraisals.

For example, Company JC1 (chemical and pharmaceutical) changed its payment system

in 1997 for both managers and non-managers. Age-related pay was abandoned for managers and reduced for non-managers. Firstly, the change of payment system for managers is described. Before the change, elements of base-pay for managers consisted of three elements; *honnkyu* (main pay), *shokuseki teate* (allowance for job accountability) and *shokunou shikaku teate* (allowance for qualification grade based on job-related ability). The main pay comprised about 70% of base-pay. The main pay increase had two aspects: one was an automatic pay increase by age and years of service and the other was an appraisal-related pay increase. About 70% of the main pay increase was an automatic pay increase. The pay increase for *shokuseki teate* (comprising 25% of the base-pay) was determined according to qualification grade (*shokunou toukyu*) and ratings of appraisals. Pay increases for *shokunou shikaku teate* (comprising 5% of the base-pay) were determined according to qualification grade. Therefore, around 50% of the base-pay was age-related pay. Company JC1 considered that this base-pay increase system was too seniority-related and problematic. Company JC1 changed the element of the base-pay to new base-pay (*shin kihonkyu*). The new base-pay was job-related pay. Company JC1 changed the pay structure from person grade as a form of 'qualification grade based on job-related ability' (*shokunou shikaku toukyu*) towards a job grade structure based on the point factors of job evaluation (Hay Guide Chart). Company JC1 called this job-related pay 'new base-pay'.

All Jobs in Company JC1 (of both managers and non-managers) were analysed and evaluated by the point factor scheme. Each employee was slotted into a job grade according to his/her job point. Employees whose jobs were slotted into higher job grades than their pay levels received immediate pay increases. On the other hand, pay levels of employees whose jobs were slotted into lower job grades were frozen. Employees whose new base-pays was lower than previous pay levels received special pay supplements to prevent pay decreases. Special pay (*tokubetsukyu*) was cut five years after the payment system changed. Hence, base-pay levels were decreased for employees who were not promoted within five years to higher job grades.

The main reason for this change is the response to increased competition. In the last several years, market competition for Company JC1 increased, especially competition against overseas-owned large pharmaceutical firms. In the past, the Japanese government did not accept clinical research data gathered in foreign countries. This discouraged overseas-owned large pharmaceutical firms to invest in the Japanese

pharmaceutical market. However, the government changed its policy toward acceptance of foreign clinical research data in 1999⁵⁸. This change shifted the stance of overseas-owned large pharmaceutical firms towards more positive investment in the Japanese market. The Japanese market is essentially a very attractive market for overseas-owned pharmaceutical firms, being the second largest pharmaceutical market in the world. Furthermore, the health insurance system in Japan provides high profits for pharmaceutical firms. Changes in government policy therefore made for a good situation for overseas-owned large pharmaceutical firms.

Additionally, the government implemented many regulations, the purpose of which included the protection of Japanese pharmaceutical firms, which tend to be smaller and their competitive power tends to be weaker than large overseas-owned pharmaceutical firms. The Japanese market became even more attractive for large overseas-owned pharmaceutical firms once the entry barrier was weakened. Company JC1 is the largest pharmaceutical firm in Japan. However, it is small in international terms (15th in the ethical drug market). In order to compete with large overseas-owned pharmaceutical firms, it needed to strengthen its competitive power in many areas such as research and development, production and sales. Moreover, operating efficiency and cost reduction are necessary.

Provision of high pay levels for high contributors is necessary in order to motivate high contributors. Furthermore, as Company JC1 is positive towards mid career recruitments, offering attractive pay levels is necessary, because these people are talented employees with high market value. Conversely, pay levels should be reduced for employees whose contribution levels are lower than the current pay levels suggest. Company JC1 has set a policy of offering the highest pay levels among the large firms for high contributors and a middle level of pay among SMEs for low contributors⁵⁹.

Additionally, Company JC1 is reducing its number of employees. There are two reasons for this for pay purposes (there are other purposes too). One is to use pay more

⁵⁸ The change in the payment system in Company JC1 started before this deregulation, because firms in the pharmaceutical industry generally already predicted this deregulation before implementation. Furthermore, the deregulation policy and the change in the national health insurance system are long term trends. Other deregulation policies and changes in the national health insurance system to prevent increasing medical costs have started. Therefore, Japanese pharmaceutical firms recognised that changes in many aspects should occur in the near future.

⁵⁹ As indicated in section 3.3.4 in chapter 3, there are larger differences of pay levels according to firm size in Japan

effectively through allocation of more money to high contributors, the other is the reduction of pay costs. Encouragement to leave for low contributors is necessary in order to reduce head count and pay cost. Decreasing pay levels can encourage low contributors to leave Company JC1. Company JC1 introduced a voluntary turnover (*kibou taishoku*) programme⁶⁰ in order to encourage low contributors to leave. Company JC1 regards pay freeze or decrease and the voluntary turnover programme as one fixed. It is sending a clear message to low contributors about the firm's judgement about their contribution levels through a pay freeze or pay decrease, with intention that low contributors may be encouraged to apply to the voluntary turnover programme.

Company JC1 applies the same policy to non-managers. However, it treats managers and non-managers somewhat differently. The payment system for non-managers also changed in 1997 (at the same time as the payment system for managers changed). Before the change, elements of base-pay for non-managers consisted of *honkyu* (main pay), *shokunoukyu* (job-related ability pay), *shokunou shikaku teate* (allowance for qualification grade based on job-related ability), *fuyou teate* (dependence allowance) and *jyutaku teate* (housing allowance). Although called main pay, main pay equates to age-related pay, as all main pay increases are automatic pay increases according to age and years of service. The main pay comprised about 40% of the base-pay. Job-related ability pay is determined by qualification grade (*shokunou shikaku toukyu*) and ratings of appraisals. *Shokunou shikaku teate* is determined by qualification grade. The job-related ability pay and *shokunou shikaku teate* comprised about 30% of the base-pay. The dependence allowance and housing allowance comprised about 30% of the base-pay. Therefore, about 70% of the base pay was not related to appraisals.

After the change of the payment system, elements of base-pay are main pay, competency pay and job-related pay. Job-related pay is determined according to job grade determined through point factor job evaluation (Hay Guide Chart). The main pay (equating to age-related pay) still remained after the change, unlike manager's pay. The reason for retaining the age-related pay is that as non-managers tend to be young and at the development stage, contribution levels can increase by years of service. Hence, seniority-related pay for non-managers is justified to some degree. On the other hand, managers tend to be old and middle aged and their development stage has already

⁶⁰ *Kibou taishoku* substantially equates voluntary redundancy. But word 'redundancy' is not socially desirable in Japan. Word '*taishoku* (turnover)' is used instead of redundancy in Japan.

passed. Seniority related-pay is not justified for managers. Another reason for retaining age-related pay is that pay levels for managers are sufficient for the cost-of-living. Therefore, managers' pay does not have to consider cost-of-living pay. But non-managers pay should consider cost-of-living to some degree, because their pay levels do not necessarily cover their cost-of-living. Age-related pay is considered as cost-of-living pay. Although age-related pay remains for non-managers, a proportion of the age-related pay against base-pay decreased from about 40% to about 25%. Further, as dependence and housing allowances were abolished, about 75% of base-pay is determined through appraisal after the change.

(2) Introduction of job factor

All the case firms used to operate person-related pay (as job-related ability pay). But seven case firms recently introduced job-related pay or role-related pay for all or some employees (mainly managers) (see table 6-3). In the case firms, job-related pay (*shokumukyu*) indicates pay based on formal job analysis and analytical job evaluation (point factor schemes), and role-related pay (*yakuwarikyu*) indicates pay based on less formal job analysis and non-analytical job evaluation. The introduction of job-related pay and role-related pay share the purposes of reduction of seniority-related pay and bringing consistency between jobs, contribution and pay levels. The case firms think that the job can provide a more concrete standard of individual contribution levels in various ways such as content of tasks and level of responsibilities. Even though the firms want to achieve pay for contribution, it is difficult to achieve without concrete standards for individual contribution levels. Line managers tend to use other criteria such as age and years of service, if a standard for assessment of individual contribution levels is not clear or abstract. Accordingly, the introduction of the job factor is often associated with a change of individual pay levels according to their job levels.

For example, Company JR1 (retail) introduced job-related pay in 1995. When it introduced job-related pay, the financial situation of Company JR1 was very bad, although it somewhat recovered from its financial difficulty compared with the early 1990s. The main cause of the financial difficulty was investment in new department stores and new businesses through bank loans at the time of the bubble economy (late 1980s). After the collapse of the bubble economy, Company JR1 faced serious financial difficulty due to decreasing sales revenue from department store business and losses

made by many new businesses including hotels (it bought the Inter Continental Hotel Chain in the late 1980s), real estate and life insurance businesses. The former management team resigned taking responsibility for the financial problems and a new CEO was appointed in 1992. The new CEO was the former board member of Company JR1, but he transferred to a subsidiary. When he transferred to the subsidiary it had serious financial problems. He brought about the recovery of this subsidiary. The reason for his transfer was a difference of opinion between him and other executives regarding the investment strategy. He claimed that investment of Company JR1 was too ambitious, and that the profit of each investment was hardly considered. But other executives who were in favour of the investments were dominant at the time and his opinion was ignored. The main bank (main creditor and main shareholder) of Company JR1 decided on his appointment as CEO in order to effect the recovery of Company JR1. The new CEO changed the firm's strategy from business expansion towards cost reduction through effective operations. This is because he thought increasing sales revenue is hardly expected under the recession, and that creating a business structure that can gain profit under low revenue growth is important. Increasing operating efficiency is the main strategy to reduce costs.

In order to increase operating efficiency, Company JR1 analysed every job in the organisation, because the CEO thought that clarifying each employee's job content would be a starting point for increasing operating efficiency. This job analysis revealed individuals' job contents were not very clear and there was a lot of replication between individuals. Company JR1 reallocated tasks to each employee in order to clarify the job content and responsibility of each employee. After the job analysis and task reallocation, Company JR1 introduced an MBO scheme in order to establish clear links between organisational objectives and individual objectives. These changes were executed between 1993 and 1994.

In late 1994, the CEO announced changes to the HRM system, and especially a change to the payment system. He put high priority on HRM for business restructuring, because he regarded that the establishment of consistency between each employee's output performance (*seika*) and reward (promotion and pay) was necessary. This is because if reward is divergent from output performance, no employee feels any motivation or commitment for increasing operating efficiency. Moreover the CEO strongly felt that HRM practices were the main problem of Company JR1 from his long working

experience in Company JR1. Further, he observed HRM practices in Company JR1 after his appointment to the CEO position. He frequently visited workplaces and discussed HRM issues with the workforce. He published a new type of house journal to change the corporate culture. HRM issues were very often featured in the house journal. For example, discussion of board member meetings about HRM issues was often disclosed in the house journal. Also a lot of anonymous opinions sent from employees about HRM practices, including criticism of the past and present practices and the results of many types of employee surveys gathered formally or informally, were reported in the house journal. The intention of the CEO in publishing HRM issues was to facilitate the commitment of employees to change to the HRM system.

In order to create consistency between output performance and reward Company JR1 introduced a job-based grade structure based on point factor job evaluation (Hay Guide Chart) and job-related pay. These two policies were introduced in 1995. The new grade and payment systems were applied to employees with more than seven years of service (they were considered managers for pay purposes). Employees with less than seven years of service were excluded. The reason for this exclusion was that they were in the development stage and their job areas were not fixed (Company JR1 recruited new employees mostly from new graduates). Before the introduction of job grade and job-related pay, the pay structure was person-based as a form of 'qualification grade based on job-related ability' (*shokunou shikaku toukyu*), and the payment system was job-related ability pay (*shokunoukyu*). The CEO perceived this payment system as highly problematic. Firstly, as 'criteria relating to job-related abilities' (*shokunou youken*) are too abstract, there are too many interpretations. The result was a subjective judgement by each line manager, and favouritism often happened. High contributors who worked hard were often given low ratings and they could not be promoted and took relatively low pay levels compared with their cohorts. From his observations, the CEO strongly felt these situations often happened. Secondly, as 'criteria relating to job-related abilities' are too abstract, many line managers implicitly use other criteria for ratings such as age and years of service. The result is seniority-related promotion and pay. The CEO perceived that these two problems created large discrepancies between actual job and contribution levels, and grade and pay levels among employees. This resulted in decreasing motivation of employees who work hard, despite the fact that these employees are the most important for business success. Further, the CEO thought that the corporate culture was very bad, as many employees focused on getting

favouritism from their bosses, and did not focus on increasing performance (in both individual and organisational performance). The CEO strongly felt and expressed the view of that the establishment of a corporate culture in which all employees could feel that real contributors are rewarded was essential for business success. The change in the payment system is a specific method in achieving the increasing motivation of employees who work hard and the establishment of a performance culture. Company JR1 emphasises output performance as an indicator to express contribution levels. This is because Company JR1 emphasised input performance as a form of 'job-related abilities' in the past, the result of which was subjective judgement and seniority-related pay due to the difficulty of measuring input performance.

When job grade structure and job-related pay was introduced, individuals' jobs were slotted into a new job grade structure determined through point factor job evaluation. This caused a large number of job grade promotions and demotions. About 20% of employees were slotted into job grades lower than those corresponding to their pay levels, and about 20% of employees were slotted job grades higher than those corresponding to their pay levels. Employees assessed as performing in higher job levels immediately received a pay increase according to their job level. Employees assessed as performing in lower job levels had their pay levels decreased, unless they were promoted within three years to job levels corresponding to their pay levels. When job grade and job-related pay was introduced, Company JR1 introduced *kibou taishoku* (voluntary turnover) programme at the same time. Employees assessed as performing in lower job levels were encouraged to apply to the voluntary turnover programme.

(3) Yearly salary system

Five case firms introduced *nenpou sei* (yearly salary system). Company JT3 implemented their yearly salary system for all employees, and the other four firms implemented it for managers or senior managers (see table 6-3). The purpose and features of the yearly salary system in the case firms are those identified in chapter 3. Increasing consistency between individual contributions (especially result or output performance) and pay levels was identified as the main purpose. Pay levels change according to the result of the appraisal in the last year. Therefore, the yearly salary system reduces seniority-related pay, and leads to a change from a stock-based payment system towards a flow-based payment system. Four firms have implemented a yearly

salary system for managers or senior managers, because they believe that the pay levels of these senior employees should be in accordance with their contribution levels more than for non-managers. Further, five firms with yearly salary system use job- or role-related pay. This indicates that the yearly salary systems tend to be associated with the introduction of job factors. This tendency is in accordance with the claims of academics indicated in chapter 3 -- i.e. that the yearly salary system has more elements in common with job-based system than with person-based system, since output performance tends to be measured based on the job.

Company JC2 (chemical and pharmaceutical) introduced *nenpou sei* (yearly salary system) for senior managers in 1996. The Company also changed its grade structure when it introduced this salary system. Here, I firstly describe the change of the grade structure before discussing the introduction of the yearly salary system. Company JC2 changed its grade structure within the same framework of person grade as a form of 'qualification grade based on job-related ability' (*shokunou shikaku toukyu*). Before the change, the qualification grade (*shokunou toukyu*) consisted of 7 grades (grade 1 being the lowest grade and grade 7 the highest); grades 1 to 3 are for non-managers, grades 4 to 6 are for middle managers and grade 7 for senior managers. After the change, the qualification grade structure was grade S1 and grade S2 for non managers (S2 is higher than S1), grade L1 and grade L2 for middle managers (L2 higher than L1), E1 and E2 for senior managers (E2 higher than E1). Company JC2 selected employees in grade E1 and grade E2 (senior manager grades) among employees from grades 4 to 7 in the old grade structure⁶¹. The reason for the selection was that Company JC2 thought that there were discrepancies between grade levels and actual contribution levels among employees. That is, employees with high grades such as grades 6 and 7 did not necessarily achieve higher contribution levels than employees with lower grades. The main reason for the discrepancies was seniority-related promotions in the qualification grade promotions. The qualification grade promotions tended to be more seniority-related than job-related. If jobs were allocated in relation to seniority, Company JC2's business performance severely suffered. Therefore, Company JC2 decided that the allocation of jobs should be more merit-based. However, direct and immediate damage to organisational performance by seniority-related promotions for

⁶¹ There were no selections for S (1.2) grade. Employees from grades 1 to 3 in the old grade structure automatically transferred to S (1.2) grade in the new grade structure. Employees with L (1.2) grade in the new grade structure were not selected employees to E (1.2) grade among employees from grades 4 to 7 in the old grade structure.

qualification grades is smaller. This is the main reason why Company JC2 accepted, to some degree, seniority-related grade promotion and discrepancies between actual job and contribution levels, and qualification grade levels.

Although direct and immediate damage by seniority-related qualification grade promotion is relatively small, it damages organisational effectiveness in the long term. One major damage pointed out by Company JC2 was the irresponsible criticism of management decisions by employees with a high qualification grade but whose job levels are low. These employees did not have decision making power since their actual job levels were low (often staff level). Line managers were unlikely to involve these employees in their decisions because they tended to have low skills and knowledge. These employees often criticised or complained about management decisions. The main reason was their high status determined by their qualification grade. They were often in the same or even a higher qualification grade than line managers. This discrepancy between actual responsibility level and status level enabled them to criticise management decisions without any responsibility. Line managers had difficulty in coping with these problems. This irresponsible criticism created many negative effects such as obstacles to management decisions, making for a bad workplace atmosphere and demotivating other employees.

Company JC2 selected employees with grades E1 and E2 in order to solve these problems. Furthermore, Company JC2 introduced a limit to the number of grade E2 members at two hundred and Company JC2 reviewed grade E2 members annually. The purpose for this annual review was to select competent employees each time. There were many employees who used to be competent but were no longer so.

Grade reviews could be achieved in the old qualification grade structure. Thus, Company JC2 did not have to change its qualification grade structure. The reason for the change to the qualification grade structure was to send a clear message to employees about changes in the reward policy. That is, through changing the qualification grade structure, Company JC2 sent a message to its employees that it now placed more emphasis on individual contributions than in the past.

Company JC2 introduced a yearly salary system for employees newly graded as E2 and E1 (senior manager level). Yearly salary was decided based on the past year's output

performance measured by performance appraisal linked to MBO. Output performance was emphasised more for senior managers than for other employees, because senior employees should have greater responsibility for organisational performance. Therefore, more attention should be focused on output and not input for senior managers. A method of measuring their output performance is MBO. At the beginning of the financial year (April), each senior manager has a face to face meeting with their superior and discusses objectives. The discussion includes the degree of difficulty of objectives. There are three elements that determine the yearly salary level: basic yearly salary, degree of difficulty of objectives and degree of achievement of objectives. The basic salary is fixed for each grade. The degree of difficulty of objectives is determined at the beginning of the MBO cycle (during or after the objective setting meeting) and the level of achievement of these objectives is determined one year later through performance appraisal. One year later, the superiors and senior managers have appraisal meetings, after which the superiors decide ratings in the performance appraisal. Appraisal ratings are sent to corporate HR, and corporate HR decides pay levels. After the decision, corporate HR informs the superior of next year's yearly salary for individual senior managers (grades E1 and E2). The superior informs individual senior managers of next year's yearly salary.

As described, Company JC2 changed its qualification grade structure and introduced a yearly salary system for senior managers in 1996. However, Company JC2 found this change was not enough to establish links between individual contribution levels and grade and pay levels. Company JC2 decided a job-based grade structure and job-related pay were necessary to establish consistency between individual contribution levels and grade and pay levels. As a result, Company JC2 introduced a job-based grade structure and job-related pay in 1999 for managers and in 2000 for non-managers.

(4) Output performance

Emphasis on result or output performance is the strongest trend in the case firms. All case firms directly link output performance with base-pay to all employees or significant sections of their employees, with biannual regular bonuses for all employees. Emphasis on output performance is the main approach for bringing consistency between individual contribution levels and pay levels by reduction of seniority elements. This is because, from past experience, the case firms consider pay based on assessed input

performance as tending to be seniority-related. In the past, the case firms gave prominence to input performance as a form of job-related ability, and pay tended to be seniority-related due to difficulty in assessing input performance. Hence, output performance is given prominence instead of input performance. Output performance is assessed in the performance appraisal (*gyouseki kouka*) that is one type of appraisals linking to pay⁶². A concrete method of emphasising output performance is by creating larger pay differentials using the ratings of performance appraisals. Ways of linking the performance appraisal and pay will be described in section 6.4 and 6.5. Emphasis on output performance is associated with a shift from the stock-based payment system toward the flow-based payment system. A specific method of measuring output performance in eight firms is measurement of degree of achievement based on objectives set. Seven firms, except Company JT3⁶³, operate this process as MBO and Company JT3 operates this process as performance management.

Company JC1 (chemical and pharmaceutical) introduced an MBO scheme, and established a direct relationship between measured performance, performance appraisal, and grade promotion and pay for managers in 1993. Reasons for the introduction of an MBO scheme and a direct link between MBO, performance appraisal, and grade promotion and pay are as follows. Company JC1 emphasised input more than output as a form of job-related ability for qualification grade promotion and pay. Company JC1 thought that it was the main cause for seniority related-grade promotion and pay. One of the main reasons was the difficulty in assessing job-related abilities. Because of this difficulty, Company JC1 included not only apparent job-related ability but also potential job-related ability. This meant that even though employees did not show high job-related ability in performing their work, their job-related ability must increase according to years of service. The problem for them was that there were just no opportunities to show their increased job-related ability. Therefore, employees who show low job-related ability (apparent ability) could be promoted to a higher qualification grade according to years of service. This was the logic that Company JC1

⁶² As will be discussed in section 6.4, all the case firms except Company JT3 (UK –owned firm) operate two types of appraisal linked to pay. One is *gyouseki kouka* (performance appraisal) that assesses output performance and one is *nouryoku kouka* (ability appraisal) that assesses input performance.

⁶³ The difference between MBO and performance management in Company JT3 means the difference between the MBO practice in JT3 before being taken over by the UK firm and the performance management practices in the UK firm.

used⁶⁴.

However, this resulted in seniority-related grade promotions and pay increases. Seniority-related grade promotions and pay increases have many negative effects. Firstly, Company JC1 had the same problems as Company JC2 described in the 'yearly salary system' section. There were many employees with high qualification grades but low job and contribution levels, and they criticised and complained about management decisions without any responsibility. These criticisms and complaints had the same negative effects as in Company JC2. Company JC1 thought one of the reasons for this was that employees who created this problem did not recognise their low contribution levels. Under the seniority-related grade promotion practices, the distinction between high contributors and low contributors was not clear. Moreover, assessment for contribution levels was not clear under-focusing on input as job-related ability, so that low contributors were unlikely to recognise their low contributions. Company JC1 thought that clarifying individual contribution levels would help them do so. Output should be emphasised in order to clarify individual contribution because output is more recognisable and objective than input.

Company JC1 introduced MBO to measure output performance and linked MBO with performance appraisal to grade promotion and pay. Company JC1 expected that individual contribution would be clarified by the introduction of MBO and the link with performance appraisal. The link with MBO and performance appraisal to grade promotion and pay increases was important in order to send a clear message to low contributors, particularly important being the link between measured output performance and pay, because of its immediate effects. Grade promotions, on the other hand, take some years to taken effect in most cases, since they are determined by adding up rating points.

The second reason for the introduction of MBO and a link with the performance appraisal was the clear message it would send about creation of a performance culture. A performance culture is necessary to compete with their competitors, especially large overseas-owned pharmaceutical firms whose competitive power is stronger than that of Company JC1.

⁶⁴ Not only Company JC1 but also other Japanese firms used this logic. This logic was a very popular so called theory of *shokunou shikaku seido* (qualification system based on job-related ability) as discussed in chapter 3.

The third reason is that Company JC1 now places a higher priority on profit than in the past. Therefore, high output performance at both individual and organisational levels are necessary to realise high profit. The reason for emphasis on profit is as follows. In order to compete with large overseas-owned pharmaceutical firms, the development of new drugs is a key issue and this requires large amounts of investment. Company JC1 now emphasises capital market-based financing more than before. This is because investment using bank loans is risky if the investment does not make a return, the development of new drugs takes a long time, and the successful development of a new drug is not guaranteed, even though large amounts of money are invested. Therefore, financing through capital market is a better method. In the past, methods for capital financing in Japan were limited. But after the mid 1980s, regulations for capital financing were relaxed. Company JC1 considers that it should utilise capital financing. However, high profits are necessary for financing from the capital market.

The fourth reason relates to pay costs; pay costs should be used effectively. Therefore, low contributors' pay should be reduced and high contributors' pay should be increased for their motivation. Freezing or decreasing pay levels for low contributors can encourage their exit from Company JC1, and it increases the effective use of pay costs.

Company JC1 firstly introduced MBO, and linked MBO and performance appraisal to grade promotion and pay increases for managers in 1993. Company JC1 introduced the same scheme for non-managers in 1997. There are several reasons why Company JC1 firstly introduced MBO and a link between MBO, performance appraisal, and grade promotion and pay for managers. Firstly, the problem of seniority-related grade promotion is more serious for managers as described above. As non-managers have lower status, they are less likely to cause a hindrance by irresponsible criticism of line managers' decisions. Therefore, sending out a message about their low contribution levels through pay is more urgent and important for managers. Secondly, pay levels for managers are higher than for non-managers. Therefore, decreasing seniority-pay for managers has a greater effect on total pay costs and pay cost allocation. Thirdly, managers tend to be old and middle aged under seniority-related grade promotion. Job-related ability for those employees is less likely to be developed according to years of service. The current output performance should be emphasised more for managers than non-managers who tend to be young and are more likely to be in the development

stage. Fourthly, line managers in managerial grades are appraisers. Therefore, line managers should be more familiar with MBO and the link between MBO and performance appraisal to grade promotion and pay increase than non-managers. Fifthly, managers tend to influence organisational performance and profit more than non-managers. Accordingly, as Company JC1 placed greater emphasis on profit, a definite policy to emphasise output performance should be firstly introduced for managers. For these reasons, the introduction of MBO, and the link between MBO, performance appraisal and pay were initiated for managers rather than non-managers.

(5) Competency

The Japanese usage of competency is devised from the US. Japanese firms started to recognise the competency approach in the mid 1990s (Motodera 2000, JPCSED 2000b). 'Competency' is a new idea for Japanese practitioners. However, the competency approach is consistently present in the case firms. Eight case firms changed from *shokunou youken* (criteria relating to job-related abilities) towards competency profiles for all or some employees. Whether 'criteria relating to job-related abilities' or competency profiles are used, and the types of competency profiles used, are summarised in tables 6-4 and 6-5. Among the eight firms, six firms particularly emphasise the link between competencies and pay, and two firms emphasise it less, although they do still link competencies with pay. There are two method of using competency profiles for pay purposes: criteria on the pay grade and criteria on the competency appraisal. These methods are consistent with the job-focused and person-focused system categories of Brown and Armstrong (1999) indicated in chapter 2. Among the six firms, Company JT1, Company JT2 (manager), Company JF1 (manager) and company JC1 (manager) are categorised by the person-focused. Company JT2 (non-manager), Company JC2 (staff to middle manager), Company JF1 (non-manager) and Company JC1 (non-managers) use both person-focused and job-focused systems. There are two types of competency profiles: generic competencies and role-related competencies. Where generic competencies are used, person-focused system is operated, and where role-related competencies are used, both person- and job-focused systems are operated in the case firms.

Table 6-4: How to link between pay and competencies in case firms

Case firm	Years of introduction of competencies	How to link competencies and pay
Company JT1	-1999 for managers -2000 for non-managers	- Competencies are assessed in appraisal directly linking to pay for all employees
Company JT2	- 2001 for all employees	- Competencies are assessed in appraisal directly linking to pay for all employees
Company JT3	- Competency profiles globally applied to the group firms	- Competencies are assessed in appraisal directly linking to pay for all employees
Company JF1	- 2000 for managers - 2002 for non-managers	- Competencies are assessed in appraisal directly linking to pay for all employees - Grade structure is made by role-related competency profiles for non-managers
Company JF2 ¹	- 1998 for managers	- Competencies are assessed in appraisal directly linking to pay for managers
Company JR1	- 2001 for below middle manager	- Competencies are assessed in appraisal directly linking to pay for below middle manager
Company JR2	- Not introduced	
Company JC1	- 1997 for all employees	- Competencies are assessed in appraisal directly linking to pay for all employees - Grade structure is made by job and job-related competency profiles for non-managers
Company JC2	- 2000 for below middle manager	- Competencies are assessed in appraisal directly linking to pay for below middle manager - Grade structure is based on role-related competency profiles for below middle manager
Company JO1	- Not introduced	

¹ Company JF2 introduced competency profile for appraisal and pay purpose for non-managers in 2003, but did not introduced at the time of the case study (from 2000 to 2002).

Table 6-5: How to link between *shokunou youken* (criteria relating to job-related abilities) and pay, and type of competency profiles linking to pay in case firms

Case firm	How to link between <i>shokunou youken</i> and pay	Type of competency profiles linking to pay
Company JT1	- <i>Shokunou youken</i> were abolished for all employees	- Generic competencies divided by employee level
Company JT2	- <i>Shokunou youken</i> were abolished for all employees	- Generic competencies for managers - Role-related competencies for non-manager
Company JT3	- <i>Shokunou youken</i> were abolished for all employees	- Generic Competencies for all employees
Company JF1	- <i>Shokunou youken</i> were abolished for all employees	- Generic competencies for managers - Role-related competencies for non-managers
Company JF2	- <i>Shokunou youken</i> abolished for managers - <i>Shokunou youken</i> are assessed in appraisal directly linking to pay for non-manager ¹	- Generic competencies for managers - Role-related competencies for some designated roles of managers
Company JR1	- <i>Shokunou youken</i> were abolished for all employees	- Generic competencies for below middle manager
Company JR2	- <i>Shokunou youken</i> were abolished for senior managers - <i>Shokunou youken</i> are assessed in appraisal directly linking to pay for below middle managers	- Competencies are not introduced
Company JC1	- <i>Shokunou youken</i> were abolished for all employees	- Generic competencies for managers - Role-related competencies for non-managers
Company JC2	- <i>Shokunou youken</i> were abolished for all employees	- Role-related competencies for below middle manager
Company JO1	- <i>Shokunou youken</i> are assessed in appraisal directly linking to pay	- Competencies are not introduced

¹ Company JF2 introduced competency profile for appraisal and pay purpose for non-managers in 2003, but did not introduced at the time of the case study (from 2000 to 2002).

As indicated above, the case firms have recently emphasised output performance as a method of reducing the seniority element. Therefore, why the case firms introduced a

competency approach focusing on the input aspect of performance is to be questioned. The reason is to compensate for the weakness of output performance-related pay. If only output performance is related to pay, employees tend to neglect important aspects, especially not become apparent in the short term, or aspects for which quantitative measurement is difficult. Competencies can provide criteria for assessment of these aspects. Further, competencies can overcome the weaknesses of *shokunou youken* (criteria relating to job-related abilities) which are too general and abstract, by provision of more concrete behavioural indicators. This is the reason why many case firms changed 'criteria relating to job-related abilities' towards competency profiles. Competencies have another strength: they can provide development criteria. This is the reason why many firms introduce competency profiles and link this to pay for non-managers more than managers. That is, the case firms think that non-managers tend to be young under the long used seniority promotion practices and that they are more likely to be in the development stage than managers. Therefore, development aspects should be emphasised more in pay determination for non-managers than managers. Although eight firms implemented competency pay, only Company JC1 uses the term 'competency pay' for non-managers. Other firms use the term either '*shokunoukyu*' (job-related ability pay) with the person grade system or the term '*shokumukyu*' (job-related pay) with the job grade system, or the term '*yakuwarikyu*' (role-related pay) with the role grade system not the term 'competency pay'.

The main reason why competency approach has rapidly defused across the case firms is assumed to be that both competencies and 'criteria relating to job-related abilities' (*shokunou youken*) concern the input aspect of the person factor. Therefore, there is no radical change due to the shift from 'criteria relating to job-related abilities' to competency profiles, and Japanese HR practitioners are familiar with the input-focused approach. HR practitioners in the case firms implementing competency profiles tend to consider competencies relating to the input aspect of the person factor as being more sophisticated criteria.

The situation for the introduction of competencies is shown using Company JC2 (chemical and pharmaceutical). Company JC2 introduced competency profiles for below middle managers in 2000. Company JC2 changed its grade structure from person grade as a form of 'qualification grade based on job-related ability' (*shokunou shikaku toukyu*) towards job grade as a form of role grade (*yakuwari toukyu*). The role grade

structure in Company JC2 can be categorised by job grade structure. But Company JC2 regards 'job grade' as meaning a grading system based on point factor job evaluation. Company JC2 did not use point factor job evaluation but used non-analytical job evaluation. Company JC2 calls this type of grading structure a 'role grade structure'. Company JC2 divided jobs in the organisation into 14 job families, and it called these 14 job families 'fields'. The fields are further divided into 25 categories by division into smaller units of job families and levels within the smaller job families. The 25 categories are called roles (*yakuwari*). Role-related competencies that include behavioural indicators, and the skills and knowledge required by each role were established.

Roles defined by the role-related competencies of all employees with qualification grades S1 and S2 (staff grade) and employees with qualification grades L1 and L2 (middle manager grade) were reviewed⁶⁵. As a result, all employees categorised in these grades were slotted into a new role grade structure which consists of 52 roles. Pay levels between old pay levels under the old qualification grade structure (introduced in 1996) and new pay levels under the new role grade structure were differentiated for most employees. Pay levels were immediately adjusted for most employees. This pay adjustment, including pay decreases, did not generate serious problems for most employees. This is because pay differentials were small for most employees, since qualification grades and pay levels were reviewed in 1996 just 4 years ago. After the review in 1996, individual pay levels were gradually adjusted to new qualification grades despite no pay decrease. However, a small number of employees had relatively large pay differentials. For pay increases, Company JC1 believes that large amounts of pay increase, for example more than 10%, have no problem. Pay levels for employees assessed as their pay levels increased more than 10% were immediately increased. Company JC2 also believes that even though pay decreases are large, for example more than 10%, they should be executed because pay levels should be accordance with an individual's contribution level. However, in practice, pay decreases of more than 10% were suspended until the following year, because the law prohibits more than a 10% pay decrease in one year.

Individual role levels defined by the role-related competencies are reviewed twice a

⁶⁵ S1, S2 are staff grade and L1, L2 are middle manager grade in the new qualification grade structure introduced in 1996. See 'yearly salary system' section.

year as one type of appraisal named '*yakuwari hyouka*' (role appraisal). Results of role appraisal are linked to pay (both base-pay and biannual regular bonuses). The method used to link the role appraisal and pay is that two times rating points of role appraisals are added, and these added points are linked to pay. If employees transfer to another field (job family) or role, the employees' new roles are determined in the soonest role appraisal after the transfer. As described, the pay structure for below middle managers is based on role-related competency. Therefore, the role appraisal assesses required competencies for each role. Company JC2 operates the other type of appraisal, namely performance appraisal (*jisseki hyouka*) for pay purposes (both base-pay and biannual regular bonuses) for below middle managers. Whilst the name of the appraisal is the performance appraisal (*jisseki hyouka*), the appraisal includes output performance and performed competencies. The method used to link the performance appraisal and pay is the same as that used in role appraisal. In other words, two times rating points of performance appraisals are added, and the added rating points are linked to pay⁶⁶.

The reason for the introduction of a role grade structure is the establishment of pay according to individual contribution. Before the introduction of the role grade structure, Company JC2 used the person grade structure as a form of 'qualification grade based on job-related abilities' (*shokunou shikaku toukyu*). Company JC2 thinks that the qualification grade promotion and pay tended to be seniority-related despite the effort to establish the qualification grade and pay levels according to contribution levels. For example, Company JC2 reviewed individual qualification grade levels in 1996, when it changed types of the qualification grade structure: however, the seniority-related grade still remains. Company JC2 considers that seniority-related grade promotion inevitably occurs under the person grade structure from its own experience. Company JC2 thought that more specific criteria are needed for grade definition such as job contents or task contents. As a result, Company JC2 introduced a role grade structure. The contents of each role were defined by role-related competency profiles.

The reason why Company JC2 introduced role-related competency only for below middle managers is that it thinks that grade and pay determination for this employee

⁶⁶ Company JC2 mixes the role appraisal and the performance appraisal and calls them the performance appraisal (*gyouseki hyouka*). Although original Japanese words differs as *jisseki hyouka* that assess output performance and performed competencies and *gyouseki hyouka* that is made by mixture of the role appraisal and *jisseki hyouka*, the author translates into the same English word 'performance', because both *jisseki* and *gyouseki* mean performance (*seika*).

category should be linked to development to some degree, and competencies can provide development criteria. On the other hand, Company JC2 did not introduce competencies for senior managers. This is because senior managers' pay should be determined according to individual and organisational output performance. Behaviour, skills and knowledge are important for the achievement of output performance for the long term. But these aspects are not directly linked to the firm's current profits. Senior managers must take responsibility for the firm's current profits. Therefore, pay for senior managers should be determined based on individual output performance and the firm's profit, and not by behaviour, skills and knowledge. This is the most important reason. The other reason is that senior managers have already passed the development stage: pay for development is not useful for those employees.

(6) Market factor

Market pay (market pay for job) is not related to individual pay levels in the Japanese payment system. That this lack of market pay should exist is a popular view, but the situation may have been changing recently as indicated in chapter 3. Some case firms use market pay. Company JC1 and Company JC2 implemented the market pay using market salary surveys. Company JC2 also uses pay data on each employee level in its industrial sector (chemical), since there are no market salary surveys that Company JC1 can participate in with a large proportion of employees. Company JT2 participates in market salary surveys for engineers recruited in mid career. Company JT3 participates in market salary surveys for senior managers. Company JR1 (department store) exchanges information about pay levels of each job families and employee level with other large department stores. As the division of job family in department stores is relatively clear compared with many other industrial sectors in Japan, Company JR1 can gather such pay data categorised. Further, Company JF1 and Company JF2 are considering the introduction of market pay in the future. As indicated, five out of ten case firms (information on market pay was not gathered from Company JR2) use market pay at least for some employees.

There are mainly two reasons for introducing market pay: the first is to increase objectivity for determination of pay levels, and the second is to know the market rate for mid career recruitment. Regarding the first reason, the use of market pay is related to the use of job-related pay. The case firms that use market pay operate job-based grade

structures not person-based except for Company JT2. For example, Company JC1 and Company JC2 introduced market pay when they introduced job-based grade structure. These firms consider once job factor is introduced for pay determination, the use of market pay is desirable. This is because market pay can increase objectivity in pay determination. The second reason is to know the market pay rates for mid career recruitment. Company JC1, Company JC2 and Company JT2 favour mid career recruitment. For example, Company JC1's reason for this is that employee profiles change according to business needs. Therefore, an exchange of employees through the exit of unnecessary employees and the recruitment of valuable employees is needed. Company JC1 introduced a voluntary turnover (*kibou taishoku*) programme as an exiting strategy. Company JC1 uses the mid career recruitment as an aspect of recruiting valuable employees. Company JT2 also favours mid career recruitment, because its business has been rapidly expanding alongside the expansion of the mobile phone market. Furthermore, Company JT2 feels there are shortages of researchers and engineers with the skills needed in the mobile phone business in the Company JT2 (while there is a excessive number of employees lacking the skills needed in the mobile phone business). Hence, Company JT2 is in favour of mid career recruitment in order to recruit employees with the skills required in the mobile phone business. Offering market competitive pay is necessary for mid career recruitment.

Market salary surveys are new and not well established in Japan. Overseas-owned consultancy firms such as Hay Consulting, Towers Perrin, William M. Mercer and Watson Wyatt conduct market salary surveys in Japan. Most participants in the surveys are overseas-owned firms. Japanese firms have recently become interested in market salary surveys. However, as many participants are overseas-owned firms, their employee size is not large compared with large Japanese firms. This makes it difficult for large Japanese firms to fully participate in the surveys. This is the case of Company JC2 and Company JT2. A major exception may be pharmaceutical industry, since the presence of overseas-owned firms is relatively large. This situation has made it possible for Company JC1 to participate in market salary surveys with a large proportion of employees. Recently, Japanese professional bodies have become interested in a market salary survey business. The Japan Institute of Labour started the market salary survey with Price Water House Cooper. JPCSED has also started a market salary survey. However, both are in the pilot stage. According to the designer of the JPCSED survey, gathering information for market pay is difficult, because many firms do not make a

direct link between jobs and pay levels. The introduction of a job factor is necessary for the spread of market pay.

Although market pay is in its infancy and has not spread yet, knowledge of market pay may spread very quickly among HR practitioners, at least in large firms. One piece of evidence for this is the high degree of recognition of market pay found in the survey by JPCSED (2002) described in chapter 3. Another reason may stem from the author's personal experience. In 1999, the author asked approximately 30 participants of a lecture in Japan about market pay. Just four or five participants knew the term for market pay or *shijyou chingin* in Japanese. In 2001, the author again asked about 30 participants of a lecture in Japan the same question. All participants understood the meaning of market pay or *shijyo chingin*. Only three participants answered that they may not introduce market pay. The other participants answered that they may introduce market pay at sometime in the future.

6.3 Pay structure and pay increase

6.3.1 Pay structure

As discussed in chapter 3, the pay table (*chingin hyou*) is popular pay structure in Japan⁶⁷. All case firms operated the pay table in the past. A characteristic of the pay table is that there is no concept of pay range. Seven case firms (Company JT1, Company JF1, Company JF2, Company JR1, Company JC1, Company JC2 and Company JT3) recently changed their type of pay structure towards the introduction of pay ranges to pay bands for all employees or some employees (mostly managers). As a result, the pay structure changed towards the 'box type' structure popular in the UK firms. The main reason why some case firms changed their pay structure is the reduction of seniority-related pay increase. As all case firms implemented *jidou shoukyu* (automatic pay increase by age and years of service) in *teiki shoukyu* (regular pay increase) in the past, the *gou*⁶⁸ of employees has been increasing annually. The pay increase according to years of service happened by automatic pay increase in the case firms, even though contribution levels of employees do not change. One of the solutions is a change of pay structure towards the box type with each pay band having a pay range.

⁶⁷ Pay table is indicated in section 3.3.4 in chapter 3 and Appendix IV.

⁶⁸ *Gou* or *gouhou* is the smallest unit of pay level which indicated in section 3.3.4 and 3.3.5 in chapter 3 and Appendix IV.

Pay drift can happen in the box type pay structure, but the extent of the pay drift may be smaller, as maximum pay points for each pay band is determined.

Under the box type pay structure, employees must be promoted to a higher grade in order to increase their pay level beyond the pay ceiling of their current grade at least in theory. This can reduce seniority-related pay. The box type pay structure was introduced especially for managers in the case firms. The case firms believe that pay levels of managers should have a stronger link with their contribution levels than those of non-managers. Because non-managers tend to be young, their contribution level may increase according to years of service. But for managers above the mid career stage, the possibility that their contribution level will further increase with years of service is low. Therefore, the manager's pay levels should be more consistent with the current contribution level. Another purpose for the introduction of the box type pay structure is to increase the control of pay costs by prevention of unnecessary pay drift.

Further, Company JT1 and Company JF1 set sub pay bands within one pay band for managers. Company JT1 has set five sub pay bands and Company JF1 has set four within one pay band. In the two firms, pay rates are decreased for higher pay bands for the same rating categories in appraisals. Because the two firms implemented a pay decrease system for managers, the pay decrease rates are higher in higher sub pay bands for the same rating categories. For these two firms, the purpose of the introduction of sub pay bands and the distinction of pay increase/decrease rates according to sub pay bands, are the decrease of pay increase rates for employees staying in the same pay bands for a long time. The relationship between rating categories and pay increase rates will be shown in section 6.4.2 using the example of Company JT1. Company JF2 and Company JC2 abandoned overlaps of pay ranges between pay bands. Company JT2 has set two pay rates for each grade in the managerial grade – the number of managerial grades is three. The purpose of the two pay rate system is the reduction of seniority-related pay increases. Company JT2 plans to reduce the number of the pay rates for one grade from two rates towards a single rate to achieve a further reduction of seniority-related pay. The current situation and changes in the pay structure in the case firms are summarised in table 6-6.

Table 6-6: Types of pay structure in case firms

Case firm	Year of change	Type of pay structure
Company JT1 Manager Non-manager	1999 2000	Box type pay structure whose pay bands have pay ranges
Company JT2 Manager Non-manager	1997-2000 No change	No pay range. Two pay ranges for each qualification grade Pay table (<i>chingin hyou</i>)
Company JT3 All employees	2000	Box type pay structure whose pay bands have pay ranges
Company JF1 Managers Non-manager	2000 2002	Box type pay structure whose pay bands have pay ranges Mixture of box type and pay table (<i>chingin hyou</i>) Box type for role-related pay Pay table (<i>chingin hyou</i>) for age-related pay
Company JF2 Manager Non-manager	1998 No change	Box type pay structure whose pay bands have pay ranges Pay table (<i>chingin hyou</i>)
Company JR1 Senior manager Manager Staff	1995 1995 No change	Box type pay structure whose pay bands have pay ranges Box type pay structure whose pay bands have pay ranges Pay table (<i>chingin hyou</i>)
Company JR2 All employees	No change	Pay table (<i>chingin hyou</i>)
Company JC1 Manager Non-manager	1997 1997	Box type pay structure whose pay bands have pay ranges Mixture of box type and pay table (<i>chingin hyou</i>) Box type for job-related pay and competency pay Pay table (<i>chingin hyou</i>) for age-related pay
Company JC2 Senior manager	1999	Box type pay structure whose pay bands have pay

Manager to staff	2000	ranges
Company JO1		
All employees	No change	Pay table (<i>chingin hyou</i>)

Note: Company JF2 changed its pay structure for non-manager towards the same direction of pay structure for managers in 2003. But this thesis describes pay structure when the case study was conducted (from 2000 to 2002).

6.3.2 Annual pay increase

There are two types of annual pay increase: *base-up* and regular pay increase (*teiki shoukyu*), and regular pay increase (*teiki shoukyu*) is further divided by *jidou shoukyu* (automatic pay increase by age and years of service) and *satei shoukyu* (appraisal-related pay increase) in Japan as discussed in chapter 3. The automatic pay increase is equivalent to age-related pay if we view it as an element of base-pay (*kihonkyu chingin taikei*). Therefore, all case firms except Company JO1 have abandoned automatic pay increases for managers, and three case firms (Company JT1, Company JC1 and Company JT3) have abandoned automatic pay increase for all employees.

6.4 Appraisal

As discussed, payment systems in the case firms are changing. One of the main directions is the creation of larger pay differentials according to ratings from appraisals (*jinji kouka*). Therefore, the appraisal is an important function when we consider the change of payment systems in the case firms in Japan. Discussions of appraisal include biannual regular bonuses as well as base-pay, although this thesis focuses on base-pay. This is because the same types of appraisals are linked to both base-pay and biannual regular bonus.

6.4.1 Types of pay linked to appraisal

Chapter 3 mentioned that one of the characteristics of *jinji hyouka* (evaluation) and *jinji kouka* (appraisal)⁶⁹ is that various types of the evaluations and appraisals are normally operated in one firm. In all case firms except Company JT3, at least two types of

⁶⁹ *Jinji hyouka* is expressed as ‘evaluation’ and *jinji kouka* is expressed as ‘appraisal’ in English. Contents of *jinji hyouka* and *jinji kouka* are indicated in section 3.3.4 in chapter 3 and Appendix IV.

appraisal relating to pay are in operation. The two main types of appraisal are performance appraisal (*gyouseki kouka*) and competency or ability appraisal (*nouryoku kouka*)⁷⁰. The performance appraisal assesses results or output performance. Output performance is measured based on objectives set, except in Company JO1 and Company JR2. Among the eight firms that measure output performance based on objectives set, seven firms operate MBO schemes and Company JT3 operates the performance management scheme⁷¹. Competency/ability appraisal assesses the input aspects such as skills, knowledge, behaviours and attitudes. The competency appraisal is based on competency profiles and the ability appraisal is based on 'criteria relating to job-related abilities' (*shokunou youken*). The type of appraisals used for pay purposes in either base-pay or biannual regular bonuses and how these are linked to pay in the case firms is summarised in tables 6-7 and 6-8.

Table 6-7: Type of appraisals linked to base-pay in case firms

Case firm	Appraisal linked to base-pay/ frequency of appraisal in a year
Company JT1 All employees	General appraisal composed by performance appraisal (2/3 weighted) + competency appraisal (1/3 weighted) / once
Company JT2 Manager Non-manager	No annual base-pay increase ¹ General appraisal composed by performance appraisal (70% weighted) + competency appraisal (30% weighted) / once
Company JT3 All employees	Performance review including competency appraisal is linked to yearly salary ² / once
Company JF1 Manager Non-manager	Competency appraisal / once General appraisal composed by competency appraisal (50% weighted) + performance appraisal (50% weighted) / twice
Company JF2 Manager Non-manager ³	Performance appraisal including competency appraisal is linked to yearly salary ² / once Ability appraisal / once

⁷⁰ Name of appraisals used in the case firms vary by each firm such as *seiseki kouka*, *gyouseki kouka*, *shouyo kouka*, *jisseki kouka*, *shokumu koudou hyouka*, *yakuwari hakki kouka*, *koudou hyouka*, *shitsumu taido kouka* and *shokunou kouka*.

⁷¹ Company JT3 is a subsidiary of the UK firm. The difference between MBO and performance management in Company JT3 means the difference between the MBO practice in JT3 before being taken over by the UK firm and the performance management practices in the UK firm.

Company JR1	
Senior manager	Performance appraisal is linked to yearly salary ² / twice
Manager to staff	Performance appraisal including competency appraisal / twice
Company JR2	
Senior manager	Performance appraisal is linked to yearly salary ² / twice
Manager to staff	General appraisal composed by performance appraisal (50% weighted) + ability appraisal (50% weighted) / twice
Company JC1	
Manager	General appraisal composed by performance appraisal (70% weighted) + competency appraisal (30% weighted) / once
Non-manager	General appraisal composed by performance appraisal (40% weighted) + competency appraisal (60% weighted) / once
Company JC2	
Senior manager	Performance appraisal is linked to yearly salary ² / twice
Managers to staff	Performance appraisal that assess level of role and performance / twice
Company JO1	
All employees	General appraisal composed by performance appraisal (50% weighted) + ability appraisal (50% weighted) / once

Notes: Explanations of notes are indicated below table 6-8.

Table 6-8: Type of appraisals linked to *shoyo* (biannual regular bonus) in case firms

Case firm	Appraisal linked to <i>shoyo</i> / frequency of appraisal in a year
Company JT1	
All employees	Performance appraisal / twice
Company JT2	
All employees	Performance appraisal / twice
Company JT3	
All employees	Performance appraisal including competency appraisal is linked to yearly salary ² / once
Company JF1	
Manager	Performance appraisal / once
Non-manager	Performance appraisal / twice
Company JF2	
Manager	Performance appraisal including competency appraisal is linked to yearly salary ² / once
Non-manager ³	Performance appraisal / twice

Company JR1	
Senior manager	Performance appraisal is linked to yearly salary ² / twice
Manager to staff	Performance appraisal including competency appraisal / twice
Company JR2	
Senior manager	Performance appraisal is linked to yearly salary ² / twice
Manager to staff	General appraisal composed by performance appraisal (50% weighted) + ability appraisal (50% weighted) / twice
Company JC1	
All employees	Performance appraisal / once
Company JC2	
Senior manager	Performance appraisal is linked to yearly salary ² / twice
Managers to staff	Performance appraisal that assess level of role and performance / twice
Company JO1	
All employees	Performance appraisal / twice

¹ There is no pay range corresponding to each grade. Two pay rates are set for each grade.

² In yearly salary system, there is no division between base-pay and biannual regular bonus in relation to appraisal.

³ Company JF2 changed the payment system for non-managers in 2003 towards the same system for managers. Now ability appraisal is abolished, and only performance appraisal (that include competency appraisal) is used for non-managers. The list is based on situation at the time of the case study (from 2000 to 2002).

In all case firms, performance appraisal is 100% linked to the biannual regular bonus except below middle manager level in Company JR2. The type of link between the appraisal and base-pay is divided into three types. The first is that in which the performance appraisal is 100% linked to base-pay. In the second the competency/ability appraisal is 100% linked to base-pay. And the third is a mixture of the performance and competency/ability appraisals linked to base-pay. The reasons for each type of link are as follows.

Firstly, where the performance appraisal is 100% linked to base-pay, the reason is that the result or output performance is most important for the work organisations, and employees with high competency/ability should achieve high results. Therefore, the performance appraisal can cover appraisal for input. Secondly, where a mixture of the performance and competency/ability appraisals is linked to base-pay, the reason is that the link with input performance is important to ensure future performance and to increase satisfaction⁷² of employees, though output performance must not be ignored,

⁷² Japanese word '*nattoku*' used in the case firms is translated as 'satisfaction' in English.

because a high level of input performance without a corresponding level of output performance has no meaning in work organisations. In addition, in the case of employees who are highly evaluated for their input performance, but are unable to achieve a high level of output performance, the receipt of a high pay increase would probably lead to a decrease in the sense of fairness or equity⁷³ among employees.

Thirdly, where competency/ability is 100% linked to base-pay, there are two reasons for this. First, output performance is more influenced by environments than competency or ability (input aspect). Control by employees is weaker for the output aspect than the input aspect. As the base-pay increase has long term effects, judgements on base-pay should be based on factors controlled by individuals in order to increase a sense of satisfaction, and equity or fairness amongst employees. Second, as the input aspect is more stable than the output aspect, base-pay should be based on stable factors to ensure future performance. However, output performance should be linked to pay. Biannual regular bonus is used for this purpose. The performance appraisal relating to output performance is linked to the biannual regular bonus. The case firms generally focus more on the performance appraisal for pay purposes than the ability/competency appraisal, especially for managers.

6.4.2 Change of link between appraisals and base-pay

All case firms recently changed relationship between appraisal and base-pay towards making larger pay differentials by result of appraisal. Although all case firms share this direction, concrete methods are different, and the methods are complicated. One of the reasons for this complexity is that change of relationship between appraisal and base-pay is usually associated with other aspects of change such as change of 'elements of pay' (*kihonkyu chingin taikai*). Here, change of relationship between appraisal and base-pay⁷⁴ associated with change of elements of pay is shown using the case of payment system for manager in Company JT1 (telecom).

⁷³ Japanese words '*kousei*' and '*kouhei*' used in the case firms are translated as 'fairness' and 'equity' in English respectively.

⁷⁴ More precisely speaking, change in elements of base pay in Company JT1 is concerned with monthly pay not base-pay, because various allowances in monthly are included for the change as indicated in section 6.6. However, word 'base-pay' is used here, because no explanation about elements of monthly pay including allowances unlike explanation in section 6.6.

Before the change of the base-pay system for managers in Company JT1

Base-pay consisted of *nenreikyu* (age-related pay) and *shikakukyu* (grade-related pay). Age-related pay was automatically increased between ¥1,000 and ¥3,000 until 55 years old. Grade-related pay was increased between ¥4,500 and ¥14,000 according to qualification grade levels and rating categories.

After the change of the base-pay system for managers in Company JT1

Elements of base-pay changed towards *shikakukyu* (grade-related pay) and *shokunou seikakyu* (job-related ability and performance pay). Relationships between appraisal and two types of pay are as follows. Base-pay is linked to *nenkan sougou hyouka* (yearly general appraisal) (this appraisal consists of a mixture of the performance appraisal weighted 2/3 and the competency appraisal weighted 1/3). *Shikakukyu* (grade-related pay) is the main element of base-pay. Pay increase/decrease rates are determined by rating categories of the yearly general appraisal and sub pay bands. Table 6-9 describes the pay increase/decrease rates.

Table 6-9: *Shikakukyu* (grade-related pay) increase/decrease rates by sub pay bands and rating categories

	I	II	III	IV	V
S	5.00%	4.50%	4.00%	3.00%	2.00%
A	4.00%	3.50%	3.00%	2.25%	1.50%
B+	3.00%	2.50%	2.00%	1.50%	1.00%
B	2.00%	1.50%	1.00%	0.50%	0.00%
C	0.00%	0.00%	-0.25%	-0.50%	-0.75%
D	-0.50%	-1.00%	-1.25%	-1.50%	-1.75%

In table 6-9, S-D are rating categories. S is the highest and D is the lowest. The appraisal procedure is first appraiser → second appraiser → coordination by divisional HR → coordination by corporate HR. The final rating is a relative rating. Rating by the first and second appraisers is an absolute rating. Divisional HR and corporate HR coordinate ratings, and they are changed from absolute to relative ratings. Forced distribution for the rating categories is implemented in a coordination process by HR. The distribution rate is S=5%, A=20%, B+=25%, B=35%, C=15%, D= hardly rated. I – V are sub pay bands within one pay band. I is the lowest sub pay band, and V is the highest sub pay band within one pay band. The pay increase/decrease rate of rating

categories is differentiated according to the sub pay band. The pay increase rate is higher in the lower sub pay bands and lower in the higher sub pay bands. The pay decrease rate is higher in the higher sub pay bands and lower in the lower sub pay bands if employees receive low ratings.

The other element of the base-pay linked to the ‘yearly general appraisal’ is *shokunou seikakyu* (job-related ability and performance pay). Grade level and rating category determine the amounts of *shokunou seikakyu* in the next year. The amounts of *shokunou seikakyu* in the next year according to the grades and rating categories are indicated in table 6-10. S to D are rating categories in the appraisal.

Table 6-10: Amounts of *shokunou seikakyu* (job-related ability and performance pay) paid monthly by grades and rating categories (¥)

	S	A	B +	B	C	D
Management grade 1	275,000	258,000	241,000	224,000	205,000	187,000
Management grade 2	256,000	239,000	222,000	205,000	186,000	168,000
Management grade 3	237,000	220,000	203,000	186,000	167,000	149,000
Management grade 4	204,000	188,000	172,000	156,000	140,000	125,000
Management grade 5	182,000	167,000	152,000	137,000	122,000	108,000

6.4.3 Base-pay decrease system

Company JT1 (manager), Company JF1 (manager), Company JR1 (manager), Company JC1 (manager), Company JC2 (below middle manager) recently introduced the base-pay decrease system. Biannual regular bonus makes up a large proportion of pay (around 30% of annual salary) in Japan, and amounts of the biannual regular bonus are fluctuated according to organisational and individual output performance. Thus, a pay decrease in the annual salary level is not new in Japanese firms. But a decrease of base-pay is a new phenomenon. The reasons for the introduction of the base-pay decrease system in the case firms are summarised.

The first reason is to increase consistency between the current contribution levels and pay levels by reduction of seniority-related pay. The case firms feel that pay increase practices in the past were seniority-related. As the current pay levels are influenced by past practices, the current base-pay levels contain seniority elements, and this creates a

divergence between the current contribution levels and pay levels. In order to increase consistency between the current contribution and pay levels, a pay decrease system is necessary. The yearly salary system (*nenpou sei*) has the same effects as a base-pay decrease, because annual salary levels are changed according to individual contribution levels (especially output performance) assessed through the appraisals. The second is to send a clear message to employees assessed as low contributors. It is not only assessed individual contribution but also organisational financial results that influence the biannual regular bonus. In this situation, although individual output performance assessed through the performance appraisal is linked to the biannual regular bonus, low ratings in the appraisal can be masked by the influence of the organisational financial result. In contrast, decreasing base-pay sends clearer a message, that is, 'base-pay is has been decreased because of your own low contribution'. The first reason is more emphasised by the case firms among the two reasons.

6.4.4 Grade promotion system in person grade system

Another purpose of the appraisals is concerned with grade promotion. Grade promotion is important for pay, since pay levels are determined based on the grade level. For all the case firms, ratings from the appraisals directly link the base-pay and biannual regular bonus. However, concerning grade promotion, the type of link between grade promotion and appraisal differs among the firms. These link types are largely divided by a job grade system (including a role grade system) and a person grade system (*shokunou shikaku seido* = qualification system based on job-related ability). In the job grade system, the grade promotion is based on promotion of job/role levels. Ratings of appraisals do not directly link to job/role promotion. In the person grade system, ratings of appraisals directly link to the grade promotion. Among the case firms, Company JT1, Company JT2, Company JF2, Company JR1 (non-manager), Company JR2 (non-manager) and Company JO1 use the person grade system. Company JF1, Company JR1 (manager), Company JR2 (manager), Company JC1, Company JC2 and Company JT3 use the job grade system (the role grade system is included in the job grade system).

The reason for the differences according to the grade type is that changes of job content provide a standard for the change of grade level in the job grade system. However, in the person grade system, there is no standard such as job content that distinguishes the

grade levels. Grade promotions can occur with no difference in job content such as tasks, hierarchical level, and levels and width of responsibility. Instead of job content, grade promotion in the person grade is mainly based on two criteria; the sum of the rating points in the appraisals and the years of service in each grade, as described in chapter 3⁷⁵. Concerning years of service, some case firms (Company JT1, Company JT2, Company JR1 and Company JR2) set minimum years of service for each grade for non-managers or low level non-managers. Further, it is noted that the minimum years of service is practically implemented where the person grade system is operated, even though there are no formal criteria on years of service. This is because conditions on the sum of rating points in the appraisals are set for grade promotions; employees must stay in the same grade until their sum of rating points match the conditions. The highest number of rating points in one year cannot not reach the conditions except for non-managers in Company JF2. Therefore, employees must stay more than two years, even though they may achieve the highest ratings. There are sixteen grades for non-managers in Company JF2. This large number of grades functions practically in the same way as the condition on years of service.

A concrete method to make the link between appraisal and grade promotion is described using the example of Company JO1 (oil). Company JO1 uses the person grade system (qualification grade based on job-related ability). The grade structure in Company JO1 is described in table 6-11.

Table: 6-11: Grade structure in Company JO1

	Grade name/ sub grade within one grade	Title
Manager	<i>Riji</i> 1-2 grades	<i>Buchou</i>
	<i>Fukuriji</i> 1 – 3 grades	<i>Fukubuchou</i>
	<i>Sanji</i> 1—4 grades	<i>Kachou</i>
Trade union members	<i>Shuji</i> 1—6 grades	<i>Kakarichou</i>
	<i>Shunin</i> 1—6 grades	<i>Hanchou</i>
	<i>Shumu</i> 1—9 grades	No title
	<i>Tantou</i> 1—9 grades	No title

Notes: within the grade, smaller number is higher sub grade. For example, *Riji* 1 grade is higher sub grade than *Riji* 2 grade.

Employees are promoted within the grade structure shown in table 6-11. Company JO1

⁷⁵ See section 3.3.3 in chapter 3 about concrete procedure of grade promotion by sum of the rating points.

has two types of appraisal: M (management and ability) appraisal and P (performance and result) appraisal. Ratings of M appraisal are linked to grade promotions. Rating categories of M appraisal consists of six levels: A, B, C, D, E and F (A is the highest and F is the lowest). Rating categories are translated into numbers (table 6-11).

Table 6-12: Relationship between rating category and number point in each grade

	A	B	C	D	E	F
<i>Riji</i>	12.0	6.0	2.0	0	-4.0	
<i>Fukuriji</i>	12.0	6.0	2.0	0	-4.0	
<i>Sanji</i>	12.0	8.0	4.0	1.5	0	-4.0
<i>Shuji</i>	10.0	6.0	3.0	1.0	0	-2.0
<i>Shunin</i>	4.5	3.0	1.5	1.0	0	-2.0
<i>Shumu</i>	4.0	2.5	1.5	1.0	0	-2.0
<i>Tantou</i>	4.0	2.0	1.5	1.0	0	-2.0

Ranges of the number points vary with the grade levels. Higher grades have wider ranges, and lower grades have narrower ranges. The necessary conditions for the sum of the rating points are set as criteria for grade promotions (table 6-13).

Table 6-13: Sum of rating points required for grade promotion

Qualification Grade	Grade promotion	1	2	3	4	5	6	7	8	9
<i>Riji</i>		22.0	7.0	0	--					
<i>Fukuriji</i>	35.0	20.0	10.0	5.0	0	--				
<i>Sanji</i>	42.0	30.0	18.0	10.0	5.0	0	--			
<i>Shuji</i>	34.0	24.0	16.0	9.0	4.0	2.0	0	--		
<i>Shunin</i>	15.5	11.5	8.0	5.5	4.0	2.0	0	--		
<i>Shumu</i>	14.5	12.0	9.5	8.0	7.0	6.0	5.0	4.0	2.0	0
<i>Tantou</i>	13.5	11.5	10.0	8.5	7.0	6.0	5.0	4.0	2.0	0

Notes: from 1 to 9 are sub grades within one grade

Table 6-13 indicates the sum of the rating points required for the grade and sub grade promotions. For instance, the *fukuriji* grade needs 35 points in order to be promoted to the *riji* grade. Employees reach the points set as the criteria and take the A or B rating category in M appraisal and in so doing, becoming candidates for grade promotion. Other conditions are also applied such as approval of the promotion committee, division

head, head of HR and CEO (conditions vary with grade levels). Employees who have satisfied all conditions are promoted to the next higher grade. Promotion from non-manager grade to manager grade further requires a pencil and paper test, interview by HR department and assignment of training courses. Conditions on the sum of rating points required for sub grade promotions within each grade are also set (see table 6-12). For instance, employees below sub grade 2 in *fukuriji* grade need 20.0 points in order to be promoted to sub grade 1.

6.4.5 Grade demotion system

Ratings in the appraisals are also related to grade demotion. The conditions for the demotion are as follows.

- ① The sum of the rating points is minus →subject of consideration of demotion
- ② Receiving F point (the lowest rating point) →subject of consideration of demotion
- ③ *Riji* and *fukuri* who take F point →automatic demotion

Company JT1 (manager), Company JT2 (manager), Company JR1 (manager), Company JR2 (senior manager), Company JC1 (manager) and Company JC2 (all employees) also recently introduced a grade demotion system. The reasons for the introduction of the grade demotion system are the same as the reasons for the base-pay decrease system.

Company JC2 (chemical and pharmaceutical) introduced grade demotions for senior managers when a new type of ‘qualification grade based on job-related ability’ (*shokunou shikaku toukyu*) was introduced in 1996 (old and new qualification grade structures were described in ‘yearly salary system’ section). At the same time, Company JC1 set a limit on the number of E2 grade (highest grade in the qualification grade structure) at two hundred. Grade E2 employees are reviewed annually. Therefore, some employees are promoted to grade E2 and some are demoted every year. The reason for the introduction of a limit on the number of E2 grades associated with demotion is that as grade E2 is the highest grade, grade E2 employees have greater responsibility for the firm’s profit. Employees taking high responsibilities for business success should be decided based on the current contribution levels. Even though employees are promoted to grade E2, this does not necessarily mean that these employees continuously perform well. The contribution of employees varies over time. Therefore, grade E2 employees should be reviewed frequently. The actual number of demotions is between 5 to 10

every year. According to HR practitioners, these numbers are smaller than expected. Company JC2 thinks a larger number of demotions and promotions are needed in order to maximise the firm's performance.

Company JC2 introduced changes to its grade structure towards a job grade structure for senior managers in 1999 and for non-managers in 2000. Grade levels of senior managers are reviewed in *gyouseki hyouka* (performance appraisal) and grade levels of below middle managers are reviewed in *yakuwari hyouka* (role appraisal). Both performance appraisal and role appraisal are conducted twice a year. The review is associated with grade promotions and demotions. This means Company JC2 expanded demotions from E2 grade (highest grade) employees to all employees. In the past, Company JC2 thought the most senior employees should be determined according to the current contribution levels, but some protection is needed for other employees. At least, once they are promoted to certain grades, they are entitled to stay at this grade. The reason why Company JC2 thought that some protection is needed was to prevent demotivation of these employees. As below middle managers tend to be younger than senior managers, their contributions are more likely to be developed in the future. But if they are demoted, they would be disappointed and this may be accompanied by demotivation.

However, Company JC2 changed its policy to no protection for all employees. This is because Company JC2 thinks that grade and pay levels according to the current contribution levels should be emphasised more in order to compete and make profits in a climate of increased market competition. Regarding profits, Company JC2 is very keen to increase shareholder value. In the area of pay, Company JC2 linked pay to the firm's profit calculated by EVA (Economic Value Added) for senior managers. It also implemented share options for senior managers. One of the reasons for this positive attitude is that Company JC2 focuses on capital-based finance. In order to raise finances from the capital market, increasing shareholder value is important. As far as demotions are concerned, the proportion of employees whose grades were demoted in 2000 was less than 5% (from 2000 to 2001).

6.4.6 Change of appraisal procedure

The link between appraisals and pays is now changing in the case firms. The main

direction of change is the creation of larger pay differentials (and promotion) according to ratings from the appraisals. This change is causing a change of appraisal procedure towards increasing transparency and participation of appraisees. In particular, some disclosure policies have been recently implemented in order to increase transparency. Before the mid 1990s, most case firms did not disclose rating criteria and standards, and results in the appraisals for appraisees. One of the reasons was the absence of the requirement for transparency, because the influence of appraisals was small at least in the short term under the stock-based promotion and payment system, and late selection practices⁷⁶. As a result, a sense of equity in each occasion of appraisal was not strongly required. Further, as many managers are involved in appraisals before a large difference is created under late selection practices, objectivity and consistency of appraisal are increased by the late career stage (Williamson 1975, Koike 1993, 1994, 1999, Yashiro 1995, 2002). At the same time, promotion and pay levels were guaranteed up to a certain level for all employees including losers in the promotion competition under seniority-related promotion and pay. Therefore, there are no complete losers in the promotions and pays. This prevented demotivation of the losers in the promotion competition.

This type of promotion and payment system functioned effectively in the past. However, changes of promotion and payment systems towards reduction of seniority elements and the creation of larger differences by ratings of appraisals require an increasing sense of equity or fairness and satisfaction⁷⁷ of employees in each appraisal. The case firms changed or are changing their appraisal procedure towards increasing transparency and participation in order to increase the sense of equity, fairness and satisfaction by increasing procedural justice.

For example, Company JF1 (food and drink) gradually increased pay differentials according to appraisal ratings, in particular for biannual regular bonuses from the early 1990s. However, there were little changes made to the appraisal system. Company JF2 introduced a formal MBO scheme across the organisation that focuses more on judgement purposes in 1996. A MBO scheme and the link between MBO and performance appraisal are not new issues, and they have been implemented for a long

⁷⁶ See section 3.4.1 in chapter 3 about the stock-based system and section 3.6.3 in chapter 3 about the late selection practices. The late selection is also indicated in Appendix IV.

⁷⁷ As indicated in the above footnotes, equity, fairness and satisfactions are translations from the Japanese words *kouhei*, *kousei* and *nattoku* used in the case firms

time. However, the development purpose was given more focused until the early 1990s. That is, development objectives were more likely to be set in relations with MBO. At the time, standardisation of the link between performance appraisal and MBO was low. MBO was treated as an option or supplement to the performance appraisal. In other words, assessment for development aspects through MBO gave additional rating points. If the assessment for output performance was not very good, ratings for development aspects relating to MBO were added. As a result, rating points in appraisals increased. Corporate HR was not very keen on the introduction of standardised formal MBO schemes across the organisation until the early 1990s.

However, the situation changed in relation to the expansion of pay differentials by the appraisal ratings. Measurement of output performance in MBO and the link between measured output performance in MBO and performance appraisals were gradually given more attention. How output performance is measured is also more important. In other words, judgment was emphasised instead of development. Company JF1 introduced more standardised procedures for an MBO scheme about how to measure output performance and how to link measured performance in MBO, performance appraisals and pay in 1996. For example, assessment based on objectives set, self-setting objectives before deciding on formal objectives, discussion before setting formal objectives, and self-appraisal before deciding appraisal ratings were set as guidelines for the MBO and performance appraisal. Furthermore, when Company JF1 changed its payment system towards larger pay differentials by appraisal ratings in 2000 for managers and 2002 for non-managers, appraisal criteria in both performance appraisal and ability appraisal were disclosed to appraisees at the times.

6.5 Individual appraisal process

6.5.1 Formal individual pay review procedure

This section concerns how individual pay is determined in the real setting. At first, the formal individual pay review procedure in the case firms is described. The pay review procedure is basically the same among the case firms, whereas details of the procedure differ. The pay review procedure includes collective aspects such as determination of pay budget and determination of pay increase/decrease rates for each rating category. But this section focuses on the individual aspects of pay reviews.

Individual pay review procedure

- ① Line managers decide ratings in appraisals



- ② Corporate HR decides the pay budget for the next year and sets pay increase/decrease rates according to rating categories



- ③ Division HR and corporate HR coordinate ratings of appraisals among division members and between divisions



- ④ Individual pay review by corporate HR

Corporate HR decides individual pay increase/decrease rates (appraisal-related pay increase/decrease) and amounts of biannual regular bonus according to rating categories

As indicated above, ratings from the appraisals are directly linked to pay increase/decrease rate of base-pay and amounts of biannual regular bonus. Hence, discussion of the individual pay review process in this section focuses on the appraisal process. Discussion of the appraisal process is limited to the four firms -- Company JT1, Company JF1, Company JF2 and Company JR1 -- where information about individual appraisal practices was gathered from sources including divisional HR and employees (line managers and non-line managers). Contents of the research for corporate and divisional HR, and employees were discussed in chapter 5. The number of HR interviewees in corporate and divisional levels, and employee interviewees is indicated in tables 6-13.

Table 6-13: Number of HR and employee interviewees

Case firm	Corporate HR	Divisional HR	Line manager	Non-line manager
Company JT1	3	1	4	4
Company JF1	4	1	5	0
Company JF2	3	1	5	5
Company JR1	4	1	4	0

6.5.2 Performance appraisal

Two types of appraisals linked to pay are in operation in the four firms: performance appraisal, which assesses output performance, and ability/competency appraisal, which assesses input performance (see tables 6-6 and 6-7). In all case firms, the performance appraisal is 100% linked with the biannual regular bonus. The type of link between appraisals and base-pay differs among the case firms, including the four firms here. Generally the performance appraisal is more influential for pay purposes than the competency/ability appraisal in the case firms. This tendency is especially strong for managerial grades.

Firstly, the process of the performance appraisal is discussed. Performance related to the performance appraisal is expressed as 'output performance', although the interviewees did not necessarily divide the output aspect and input aspect, in the interviews. 'Contribution' is used to express performance including both output and input aspects as discussed in Chapter 2. Discussion for the performance appraisal focuses on a correlation between output performance and pay levels. The correlation is related to a sense of equity. According to equity theory (Adams 1965), a person tends to perceive equity if he/she perceives the ratio between input (all things input by a person) and output (reward) as being equal to their perceived ratio between input and output of people who are compared by the person. The discussion relating to the performance appraisal is divided into setting objectives and ratings. Output performance is considered as input by employees and objectives relating to output performance are considered as the bases of output performance level. Pay is considered in terms of output received by employees. Therefore, if objective levels (input levels) and pay levels (output levels) are correlated, the sense of equity can be high. Pay levels are judged by grade level, since pay levels are related to the grade levels.

(1) Setting objectives

Firstly, the thesis discusses objective setting. The four firms have implemented self objective setting. Before reaching formal decisions on the objectives, self set objectives are submitted and discussed in an objective setting meeting (the meeting is often combined with the appraisal meeting). Methods of setting objectives are divided into the person grade and job grade systems. In the person grade system, one method used as the

cascading process from organisational to individual objectives. In the job grade system, two methods are used: a cascading process and objectives based on job accountabilities. Company JT1, Company JF1 and Company JF2 are categorised into the person grade system and Company JR1 is categorised into the job grade system. Although Company JF1 has introduced the role grade system, introduction of the role grade based on role-related competency profiles for non-managers was achieved in April 2002. Setting objectives (and also appraisal) had not been practiced under the role grade system at the time of this research. In the case of managerial grades in Company JF1, the role definitions are too brief. Thus, the grade system in the manager grade is substantially the person grade in relation to objective setting and appraisals, because concrete standards for the setting of objectives and appraisals are practically non-existent.

In the person grade system, only a cascading process is used for setting objectives. It is assumed that objective and grade levels are unlikely to be correlated, because of a lack of concrete standards to decide objective levels according to grade levels, such as job content or job accountability. Instead of the standard, all line manager interviewees in the three firms have rough rules to distinguish the objective levels between managers and non-managers. That is, managers are assigned higher level or more difficult objectives than non-managers. In the case of Company JF2 (food and drink) whose all interviewees are sales persons, the main rule for the line manager interviewees is that they assign large distributors such as wholesalers to managerial grades and assign small distributors such as retailers to non-managerial grades. However, according to the interviewees, this rule is not applied to all members of their branches. Two non-manager interviewees (non-managerial grades) deal with large wholesalers. They are appraisees of the line manager interviewees who mentioned the above rules in the interviews. These non-manager interviewees explained that the level of their objectives may be higher than for some manager grades in their branches. According to the interviewees of Company JF2, these cases of reverse correspondence between the objective and grade levels are not rare in the firm. From these facts, it is guessed that the objective and grade levels are not highly correlated. A similar situation is described by the interviewees in Company JT1 and Company JF1.

Line manager interviewees in the three firms explained that there are no clear or concrete standards for setting objectives, therefore, the levels of objectives are influenced by the attitudes of individual appraisees for self objective setting. If the line

managers judge that the self objectives are too difficult, they have sometimes suggested decreasing the levels of the objectives (they do not necessarily make the suggestion and whether they suggest this or not depends on the financial situation of their firms and divisions). If employees cannot achieve the objectives due to the high level of difficulty inherent in the objectives, even though they achieve high output performance, line managers have difficulty giving them high ratings in the performance appraisals. Even though they give high ratings due to recognition of high output performance, corporate or divisional HR can reduce the rating points. In fact, many line manager interviewees have experience of corporate or divisional HR changing their ratings. According to the line manager interviewees, the reason for the corrections by HR was that their ratings were too high. From these comments from the interviewees, it is assumed that there are few objectives or concrete standards for objective levels according to grade level in the three firms. The levels of objectives are largely determined by subjective judgment.

In contrast to the three firms, Company JR1 with the job grade system decides upon deployment of employees according to their job grades. Objectives are set based on accountability of the job. Line managers know the accountability of the individuals that report to them. If the change in job accountability is large, the job grade will change. These are basic rules, but there is some flexibility in practice. However, the levels of objectives are generally related to the job levels. At least, there is no large divergence between the grade levels and objective levels according to the interviewees in Company JR1.

Regarding agreement⁷⁸ on setting objectives, in Company JR1, line managers are required to reach agreement. According to divisional HR and line manager interviewees, members agree with the objectives in most cases. In the other three firms, line managers and non-line managers are not familiar with establishing agreement on their objectives. Both line manager and non-line manager interviewees answered that they must accept the objectives regardless of agreement. If the assumption of goal setting theory or procedural justice is applied (Locke 1968, Batrol and Locke 2000, Kanter 1992, Folger and Cropanzano 1998), employees' motivation may be low in the three firms due to arguments relating to equity and agreement on the objectives.

⁷⁸ Japanese word 'goui' is translated as 'agreement' in English.

(2) Rating

The second point concerns ratings of the performance appraisal. The four firms operate self appraisals and these are submitted to appraisers before the meeting. Preparation for the meeting is different for different interviewees. One non-line manager interviewee spends about one day for the preparation and one line manager interviewee spends about a half day per appraisees. Some line manager interviewees do not particularly concentrate on the preparation and some non-line manager interviewees spend only a little time to fill in the self appraisal forms. In the case of managers who do not concentrate on the preparation, they do at least think in advance.

According to the interviewees, in the appraisal meetings, judgements on the output performance of appraisers and appraisees are discussed. But in Company JF1, Company JF2 and Company BT1, discussion is mostly about the general impression of output performance levels, not concrete or specific measurement of output performance. However, this does not mean output performance is not discussed between line managers and their members. In fact, concrete output performance is often discussed between line managers and their members as usual business, but the discussion is not strongly related to the appraisals.

In contrast, according to HR and line manager interviewees in Company JR1, ratings of the appraisals and measurement of business performance are closely related and the concrete measurement of output performance is discussed in the appraisal meetings. MBO and performance appraisals forms used by the line manager interviewees and other line managers show this close relationship between the measurement of business performance and the judgement of the appraisals.

For example, there are many types of forms relating to MBO and performance appraisal in Company JR1 (retail). Further, one line manager develops and uses several types of forms relating to MBO and performance appraisal. Some examples of the forms used by one line manager (manager of shoes counter) are exemplified here to show the actual contents of the forms. These examples can show how the measurement of business performance and the judgement of the appraisal are closely related. One of the forms articulates overall targeted output performance (sales and profit) in his section, targeted output performance (sales and profit) in each category of shoes, and definite objectives

(output performance levels and actions to achieve output performance) of each employee within this 6 months. Another type of form articulates targeted output performance in his section in both overall and each category of goods in each month and the time schedule for achievement of each objective of each employee. Furthermore, he fills in actual output performance for his section and degree of achievement of each objective of each employee on the same form. This practice makes a clear comparison between targeted output performance and targeted achievement of objectives in each month, and actual output performance and achievement of objectives in each month. In another type of form, he fills in communicated plans with each employee in order to achieve each objective of each employee. In another type of form, he fills in ratings of performance appraisal and reasons for the ratings.

The appraisal meeting takes about 15-60 minutes in interviewees in Company JT1, Company JF and Company JF2 and about 1 to 2 hours in interviewees in Company JR1. After the meeting, line managers decide the ratings of the appraisals. In Company JR1 the appraisees are informed of their final ratings. In the other three firms, the appraisees are not informed of their final ratings. In Company JF2, as the relationship between rating category in the performance appraisal and the biannual regular bonus level is disclosed in the internal network system, appraisees can know their rating categories, if they calculate the bonus rate. Whether or not the appraisees are informed of their ratings by the first appraisers depends on each line manager. Among the interviewees, the proportion of those who inform their appraisees of the rating categories and who are informed of their ratings by their appraisers is around half.

Regarding agreement on ratings by appraisees, none of the four firms require agreement making with appraisees. However, in Company JR1, divisional HR and line manager interviewees reported that agreements are established in most cases at least formally, but that the degree to which employees really agree is not certain. In the other three firms, both line manager and non-manager interviewees are unfamiliar with the concept of agreement. This is the same as setting objectives.

The next point is the correlation between output performance level and rating level, and the correlation between grade level and output performance level. Concerning objective levels, there are few objective and concrete standards corresponding to grade levels, and the grade and objective levels are sometimes divergent in Company JT1, Company JF1

and Company JF2. Yet, line manager interviewees in the three firms reported that ratings are generally correlated to output performance levels. That is, employees who achieve higher output performance generally take high ratings in performance appraisals. However, the correlation between the output performance levels and grade levels is lower. The main reason for this is that the objective levels as the basis of the output performance are not highly correlated to the grade levels. In contrast to the other three firms, the output performance levels and grade levels are generally correlated, according to interviewees in Company JR1. The main reason is that the output performance is measured based on the objectives set, and the objectives are decided based on the main accountabilities allotted to each job.

6.5.3 Competency appraisal

The other type of appraisal linked to pay is competency appraisal⁷⁹ in the four firms except for senior managers in Company JR1. Correlations between contribution levels and grade levels are weak in competency appraisals. This is the same as for performance appraisals. Discussion on the competency appraisals focuses on the particular problem of the high subjectivity of competency appraisals .

Line manager interviewees explained that competency appraisals essentially consist of subjective judgments. Although they pointed out that the objective levels is a largely subjective judgement in the performance appraisal, they perceive that judgement in the competency appraisal is even more subjective. Nevertheless, line managers in Company JT1, Company JF2 and Company JR1 do not think that competency appraisals are very problematic. The main reason for this may be the minor influence of competency appraisals in the three firms (see tables 6-6 and 6-7). The majority of line manager interviewees in the three firms explained that competency appraisals are useful as supplementary information. Only appraisals used for output performance cannot establish equity or fairness among employees, since output is influenced by environmental factors. Therefore, input or process should be taken into account in the appraisals. However, the author's impression is that the line manager interviewees are

⁷⁹ Ability appraisal was 100% linked to base-pay for non-managers in Company JF2 at the time of the case study (from 2000 to 2002). The situation with ability appraisal for non-managers in Company JF2 is omitted, because the discussion on the competency appraisal covers the situation of ability appraisal in Company JF2. That is, the ability appraisal is basically subjective judgment, but line managers did not think the problem seriously, mainly because non-managers are in development stage in their career.

generally not very serious about the competency appraisals; except in Company JF1, because influence of the competency appraisal is minor.

In contrast to the other three firms, line manager interviewees in Company JF1 are serious and doubtful about the competency appraisal, especially for managers. The line manager interviewees support the competency appraisal for non-managers to some degree, since the development aspect should be related to pay increases for non-managers to some degree. But the competency appraisal is problematic for managers. This is because the managers who have already passed the development stage in their career should be assessed by their output performance, not process or input. The reason for the seriousness and skepticism of line manager interviewees in Company JF1 is that the competency appraisal links 100% to base-pay for managers in Company JF1⁸⁰.

However, according to HR interviewees in company JF1, substantial influence of the competency appraisal for manager's pay is not very large for mainly two reasons. First, grade promotion is determined by change of the role levels. If employees stay in the same role grade for a long time, the base-pay increase rate decreases even though their ratings in the competency appraisal are very good. Second, the proportion of biannual regular bonus against annual salary is large in Company JF1 (about 40% of annual salary for managers, if managers are in the mid rating category), and the biannual regular bonus is linked to the performance appraisal. Therefore, the performance appraisal strongly influences annual pay levels. The main purpose of the competency appraisal is deployment, but this aspect may not be clearly communicated to the line managers. A 100% link between the competency appraisal and manager's base-pay leads to skepticism among the line manager interviewees.

As discussed, line manager interviewees do not think the competency appraisal is very reliable, since judgment in the appraisal is highly subjective. However, they generally agree with the competency appraisal at least in principle, if influence by the competency appraisal for pay and promotion is not large. In contrast, where the competency appraisal has a large influence, they are skeptical about it, especially when it is being used on managers.

⁸⁰ For non-managers in Company JF1, mixture of performance appraisal and competency appraisal links to base-pay.

6.5.4 Perception for pay

As discussed, the main reason for the difference in correlation between the contribution and pay levels between the three firms (Company JT1, company JF1 and Company JF2) and Company JR1 is whether the person grade system is used or the job grade system is used. In the person grade system, correlation between the grade and contribution levels tends to be weaker than the correlation in the job grade system. If the assumption of equity theory is applied, the sense of equity of the employees may be low and they may tend to be demotivated. Moreover, agreement on objectives and ratings are low in the three firms, therefore, employees in the three firms may be demotivated if the assumptions of goal setting theory and/or procedural justice is applied. However, there is no evidence of the low sense of equity and low motivation from the interviewees in Company JT1, Company JF1 and Company JF2. In these three firms, divergence of pay levels against contribution levels seems to be the normal state of affairs for the interviewees.

Their perceptions seem to be that pay levels are related to age. For instance, when the author asked the interviewees ‘do you know the pay levels of employees who engage in similar jobs to yours in other firms in the same industry?’ two interviewees in Company JT1 answered ‘yes I know them, because pay levels for the same age groups among large firms in the telecom-sector are almost the same’. Two interviewees in Company JT1 answered ‘yes, I know them, as my ex-colleagues with a similar age to me changed to their job in other firms in the telecom sector. I heard about their pay levels’. Although the author asked about pay levels for job not pay levels for age, they answered the question as if it had been asked about pay levels for age. Further, all interviewees in Company JF2 gave the author similar answer ‘I do not know exactly, but I have heard that the pay levels of Company K are higher than ours’. The conversation subsequent to this answer revealed that they compared pay levels of the same age groups between the two firms. They did not compare pay levels for jobs. It is considered from these answers that their basic perception of pay is that pay levels are attached to age. Therefore, even though the standard used in judgement in appraisals is not strongly correlated with the grade and pay levels, they are unlikely to perceive this as a serious problem.

As seniority-related pay increases have been practiced for a long time, this practice has

formed perception of pay as 'par for age'. As a result, employees are unlikely to pursue correlation between contribution levels and pay levels in each occasion of pay determination. However, the interviewees recognise recent change in HRM practices. In particular, interviewees in Company JF2 realised that there had been recent changes in promotion policy. Almost all interviewees in Company JF2 mentioned that young managers had been appointed to high positions in the last few years, while promotion had been based on age in the past. Accordingly, the line managers feel that the influence of the appraisals has become stronger for promotion and pay than it was in the past. Interviewees in Company JT1 and Company JF1 are aware of the recent change in their payment system towards larger pay differentials by ratings. They mentioned that the zero base-pay increase and base-pay decrease for managers was a recent occurrence. Such things never happened in the past. Moreover, Company JT1 executed grade demotion for managerial grades in 2001 for the first time. The interviewees realised that change on promotion and pay policies had taken place.

Another reason that employees are less likely to pursue correlation between contribution level and pay levels in each occasion of pay determination is that even though high correlation is not achieved in the short term, it will be realised in the long term. For instance, line managers in Company JF1 explained that male university graduate employees who have high promotional opportunities usually engage in managerial jobs before promotion to a managerial grade. This is the firm's tradition. As these employees have a high opportunity for promotion, they will be compensated in the long term, and their intrinsic reward is also higher than for other employees. Accordingly, the imbalance between pay levels and contribution levels in the short term is acceptable. This perception is consistent with the stock-based payment system identified by the thesis as one of the characteristics of the Japanese payment system. However, the line managers think that this aspect is also changing. The reasons are mainly two. The first is the change of perception of young employees. Young employees tend to require equity not only in the long term but also in the short term. The second is the change of HRM practices. In the past, almost all male university graduate employees were promoted to managerial grades, and the majority was promoted to the mid level of managerial grades. But now Company JF1 is changing the grade system and the promotion and payment systems towards the creation of large differences among employees with the same level of academic background. The line managers think that the establishment of correlation between the contribution levels and pay levels in each occasion of pay determination

will be more important than in the past.

As described, line managers perceived the need for changes in appraisal practices towards a higher correlation between the grade and contribution levels, and the need for establishment of concrete standards of the contribution level corresponding to the grade levels. But they are not changing their practices so much or they are not making a large effort to change them. One of the reasons may be that they do not strongly perceive the need for change. They pointed out the current problems and the need for the change, because they were interviewed about the practices of appraisal and other issues related to pay. This is a research effect that the research setting changes the attitude of the subjects (Gill and Johnson 1997, Hollies 1994, Miles and Huberman 1994). Another reason may be that they have little decision making power relating to the change, because the main issue that they identify as a problem is related to areas decided by the HR function such as criteria on the grade levels, and the promotion and pay determination systems. Regarding the decision for ratings of the appraisals, HR at corporate and divisional levels is very powerful in terms of coordination. The line managers have few opportunities to change the situation.

The author's impression from the interviews is that line managers in Company JR1 set a higher priority for the appraisals than the other three firms. For example, line managers make their own MBO and appraisal forms in Company JR1. Company JR1 abolished standardised MBO and appraisal forms in 2000. All line manager interviewees exhibited their own forms, to show that their comments are filled in as indicated above. Further, divisional HR showed various forms used by individual managers. These forms indicate the extent to which line managers are serious about appraisals. On the other hand, the author was unable to find such indications of seriousness from the MBO and appraisal forms in the other three firms. The time of meetings relating to appraisals also differs as indicated above. Lower levels of seriousness for appraisal by line managers in the three firms do not mean that the line managers are not serious about the levels of contribution of their members. On the contrary, they are very serious about them, particularly output performance. Most line manager interviewees answered that they always think about their members' contribution levels and often discuss them. Further they sometimes directly support improvement of contribution levels. However, this seriousness does not link strongly to the appraisals.

6.5.5 Coordination by HR function

Many line manager interviewees mentioned that corporate or divisional HR had changed their ratings in the appraisals. The reason for the change was the same – their rating points were too high. In Company JT1 and Company JF1, divisional and corporate HR coordinates rating points and they convert the absolute rating to a relative rating and impose distribution rates decided by corporate HR. According to divisional HR in the two firms, they calculate the average rating points of each grade, briefly defining each job family and each section, and they coordinate the rating points in order to even out average rating points between grades, job families and sections. Forced distribution is also introduced by the divisional HR. The units of the forced distribution are the job family and grade level in Company JT1, and the grade level in Company JF1. Further, divisional HR in the two firms corrects for the reverse situation, between reputations about individual contribution levels and ratings, in order to establish consistency of ratings as judged by many line managers. In order to compare reputations and ratings, corporate and divisional HR collects information about the reputation of individuals. This comparison surprised the author. In particular, the divisional HR of Company JT1 whom the author interviewed, deals with the appraisals of about 500 employees. He said ‘this is my job’.

Company JF2 does not formally implement relative appraisal and forced distributions. Nonetheless, the corporate and divisional HR coordinates ratings to some degree for two main reasons. The first is to create consistency for ratings between line managers and divisions. The second is if ratings are according to contribution levels, ratings should have a certain degree of distribution, as the contribution level should differ among employees. But, unlike in Company JT1 and Company JF1, the coordination by the corporate and divisional HR is not very strict in company JF2. For example, the difference between average rating points between sections and departments is considered acceptable to a certain degree.

The power to coordinate in Company JR1 is also strong, but the method of coordination differs from that in the other three firms, as a rating committee established at the store level coordinates not the HR in Company JR1. Two line managers in Company JR1 explained that they have been required to reduce ratings of competencies and final ratings from the rating committee. The reason for this requirement was that the line

managers rated competencies and the final rating for some members highly, but the member's ratings on output performance were not very good. More importantly the line managers did not recommend their grade promotions. The committee asked them why they had not recommend job promotion, despite the fact that ratings of some members had been sufficient to make them candidates for job promotion. The line managers changed the ratings because they did not regard the members as being ready for promotion towards higher jobs.

Company JR1 has implemented *genshoku tekisei hyouka* (aptitude appraisal for the current job) that is related to the job grade promotions and demotions. Line managers assess appropriateness of promotion and demotion through the aptitude appraisal. If promotions/demotions are suggested as a result of the aptitude appraisals, they fill in their suggestion for the next job for them. Yet, suggestions for job promotion/demotion do not directly link to job promotion/demotion. This is one of the inputs for the decision of job promotion/demotion. Regarding the gathering of information about individual contribution levels, corporate and divisional HR in Company JF2 and Company JR1 also gather the information to prevent the reverse situation between the reputations regarding contribution levels and rating levels.

The coordination by the HR function seems to be strong in the four firms. However, neither HR practitioners nor line manager interviewees particularly think so. Two reasons for the perception of the interviewees are considered. One is that corrections for ratings by the HR function do not often occur. Although many line manager interviewees have the experience of their ratings being changed by the HR function, the number of times this has occurred is not large -- and has only occurred once in most cases. The number of appraisees for each line manager interviewee is between two and about forty. The frequency of the appraisals is three times in one year in most cases. In this situation, just one correction is not a large number. Yet, we must not overlook the possibility that line managers may become more strict after their ratings have been corrected by the HR function. The other reason is that coordination by the HR function is taken-for-granted for employees in the case firms. Most interviewees have only worked for the case firms, and it is the HR practices within the case firms that have formed their concept of their appraisal processes.

6.6 Payment system in Company JT1

This section discusses the payment system in company JT1 (one of the Japanese case firms). The payment system in BT2 (one of the UK case firms) will be discussed in the next chapter. The purpose is to discuss payment systems in each firm in a more detailed way. The reason for selecting only one case firm in each country is that the author judged it would be better to have a more detailed discussion for a smaller number of the case firms than less detailed discussions for a relatively larger number of the case firms.

There are two main reasons for selecting Company JT1 and Company BT2. Firstly, and most importantly, the two firms are among the four firms in which the author gathered the largest amounts of information (see section 5.6.3 in chapter 5). Secondly, the two firms share the same industrial sector, being in the telecom industry. The author did not find significant industrial sectoral differences in payment systems between the case firms. However, the author judged that the same industrial sector is desirable, because external environmental factors are similar. In particular the telecom industry in Japan and the UK share many similarities such as rapid and radical changes in technology, rapidly growing global competition, and industry deregulation. Discussion of the payment systems in Company JT1 and Company BT2 is limited to the time during which the case studies were conducted (from 2000 to 2002 for both Company JT1 and Company BT2). Changes after the case studies were complete are beyond the scope of the discussion.

6.6.1 History and recent change in Company JT1

Company JT1 was formed by former a national railway firm (it was privatised and divided into six regional railway firms in 1987) in 1984, just before the telecom business (network provider business) in Japan was released to private business and the former public-owned monopoly network communication firm was privatised. When Company JT1 was formed, its business area was domestic, long distance, fixed phone business, but it expanded into other telecom businesses such as the regional fixed phone business, the international fixed phone business and the mobile phone business. Company JT1 had a full range of services as a telecom network provider at the time of the case study. Company JT1 is the third largest and controls 16% of the telecom network business in the Japanese telecom market.

The main problem of Company JT1 is its relatively small size compared with the former monopoly telecom firm as the industrial giant. This is because economies of scale are very important to the telecom network provider business in order to invest in the telecom network on a very large scale and to increase efficiency in the use of telecom networks. The financial results of Company JT1 were not good mainly due to its relatively small size. Company JT1 started as an alliance, holding shares mutually with AT&T and BT in order to expand the telecom network world wide in 1999. In doing so, Company JT1 expected to improve customer service and increase economies of scale. As a result, Company JT1's major shareholders (regional railway firms) sold their shares to AT&T and BT. The purpose of AT&T and BT in making an alliance with Company JT1 was to invest in the Japanese telecom market.

However, AT&T and BT reduced global investment as a result of their bad financial performance. Instead of AT&T and BT, a UK mobile phone firm (one of the UK case firms) was interested in investing in Company JT1 in order to invest in the Japanese telecom market. Between 2000 and 2001, AT&T and BT sold their shares to the UK mobile phone firm. Furthermore, the regional railway firms (other major shareholders of Company JT1) sold their shares to the UK mobile phone firm despite strong resistance from the management of Company JT1 (top management members such as the chairman and president at the time were transferred from the regional railway firms). The main reason expressed by the regional railway firms was: we should sell our shares to the UK mobile phone firm in order to increase our shareholder value. As these firms are now privately-owned, shareholder value is very important in the management decision. The UK mobile phone firm acquired Company JT1 in 2002. After the acquisition, top management members changed and business areas were reviewed. As a result, the UK mobile phone firm sold the fixed phone business of Company JT1 to Lipple Wood (an American investment firm) in 2003 (after the case study).

6.6.2 Main HRM policies between 1999 and 2001

The main HRM policies between 1999 (when Company JT1 changed its payment system) and 2001 (before acquisition) are summarised here. Company JT1 set three main HRM policies in 1999: the first was the establishment of an early selection and development system for senior managers (establishment of a fast track course), the second was the establishment of *seika shugi chingin* (output performance-based

payment system) and the third was the restructuring of the appraisal system to facilitate an output performance-based payment system.

The alliance with AT&T and BT led to the formation of the first policy. With the establishment of the alliance with AT&T and BT, one person from each firm became a board member of Company JT1. Their age was about 40. These young board members generated the idea among the Japanese board members that Company JT1 should have a fast track HRM system in which talented individuals could be promoted to senior positions at an earlier career stage than in the current situation. After convincing Japanese board members that age should be less important, Company JT1 created a selection and training system in order to find young, high potentials and to develop their career. Company JT1 selected 22 employees (from 30 to 35 years old) as candidates for future senior management roles in 2000, and it started deployment, and began investing in their development including overseas deployment, training, and studying abroad.

The second policy was the establishment of an output performance-based payment system. This was considered more urgent in a context where already strong domestic market competition was compounded by global competition. Profits from the fixed voice phone business were rapidly decreasing, and Company JT1 had to shift its main business area from voice communication towards data communication, and from fixed phones towards mobile phones. However, this shift required high levels of skills to develop and deliver new service areas, and output differences between individuals became greater in this situation. Nonetheless, pay levels were still largely seniority-related. This made for large discrepancies between pay levels and individual contribution levels. HR practitioners believed that these large discrepancies created dissatisfaction and decreased motivation among young employees, whose pay levels tended to be low under seniority-related pay. The number of young employees leaving Company JT1 to join other firms had increased in the last several years, and HR practitioners perceived that increased turnover was related, to a certain degree⁸¹, to pay levels partly on the basis of information on employee opinions.

Another factor that made Company JT1 focus on changing the payment system was the facilitation of mid-career recruitment. Company JT1 was positive towards mid-career

⁸¹ There may be another major reason. This is because most employees who quit Company JT1 and changed to other firms were employees who worked for the acquired firm by Company JT1 in 1997.

recruitment as a means to develop and deliver new telecom services. However, pay levels for young people offered by Company JT1 were relatively low compared with new venture firms and overseas-owned firms. Many new venture firms and overseas-owned firms had recently entered the telecom market. These firms recruited young competent employees with new telecoms skills by offering high pay levels⁸². Company JT1 had difficulty recruiting young competent people with new telecoms skills mainly due to seniority-related systems. Company JT1 was required to change the seniority-related payment system and establish pay according to individual contribution levels in order to retain and recruit young competent people.

Company JT1 had excessive numbers of middle-aged and old employees with old network skills whose pay levels tended to be high under seniority-related pay. The firm needed to change pay allocation in order to offer higher pay levels for young competent employees without increasing the total pay cost. Hence it reduced seniority-related pay and placed greater emphasis on individual contribution. In particular, Company JT1 emphasised output performance aspects rather than input performance such as job-related ability, on the grounds that the latter tended to reinforce seniority-related pay.

The third policy was the establishment of an appraisal system to facilitate an output performance-based payment system. The establishment of an appraisal system that could measure output performance objectively and consistently was necessary to achieve an output performance-based payment system that employees would perceive as fair.

6.6.3 Payment system for managers before the change

Company JT1 changed its payment system and appraisal system for managers in 1999 and non-managers in 2000 in accordance with the above key HRM policies. Here I focus on payment and appraisal systems for managers (the payment system and appraisal system for non-managers share the same principles, and their contents are almost the same).

⁸² This is also the reason why number of young employees quit Company JT1 increased.

(1) Elements of monthly pay before the change

As well as appraisal, changes were focused on elements of monthly pay and on the pay structure. I will discuss each of these in turn. Although this thesis uses the term ‘base-pay’, Company JT1 uses ‘monthly pay’. This is because the change relating to ‘the elements’ includes not only base-pay but also various types of allowances. Company JT1 thinks that a change in allowances is also significant as a change of the payment system, because the proportion of allowances in monthly pay is relatively large, as the cost-of-living allowances amounted to 20% of monthly pay before change. Considering the importance to Company JT1 of change in allowances, ‘monthly pay’ instead of ‘base-pay’ is regarded as the subject of change in the payment system.

Elements of monthly pay, the contents of each element and methods for annual pay increases of age-related pay and grade-related pay before the change are as follows. Only the main elements applied to most employees are mentioned as elements of monthly pay (there are many types of allowances in monthly pay, and minor allowances are excluded). Among the elements of monthly pay, only age-related pay and grade-related are increased annually.

Elements of monthly pay before the change

1. *Kijunnai chingin*⁸³

1.1 Main pay (*honinkyu*)

1.1.1 Age-related pay (*nenreikyu*)

Age-related pay automatically increases until 55 years old between ¥ 1,000 and ¥ 3,000.

1.1.2 Grade-related pay (*shikakukyu*)

Grade-related pay increases between ¥ 4,500 and ¥ 15,000 according to qualification grade levels and rating category in appraisal.

1.2 Dependence allowance (*fuyou teate*)

Paid ¥ 20,000 for each dependant

1.3 City allowance (*toshi teate*)

Level of city allowance is differentiated by place of work. Company JT1 divides the place of work into five categories and differentiates levels of city allowance. The highest level (Tokyo and surrounding area) is 15% of the main pay and the lowest

⁸³ See section 3.2 in chapter 3 or Appendix IV about *kijunnai chingin*.

level is 0.

1.4 Housing allowance (*juutaku teate*)

Level of housing allowance is decided by an employee's status on whether or not he/she is the main earner in his/her family

2. *Kijungai chingin*⁸⁴

2.1 Manager allowance (*kanrishoku teate*)

Manager allowance is paid as fixed amounts of money determined by qualification grade level

2.2 Cold place allowance (*kanreichi teate*)

Level of cold place allowance is decided by two conditions. One is place of work. The place of work is categorised into four levels by which pay level is differentiated. One is an employee's status, whether or not he/she is the main earner in his/her family.

Dependence, city, housing and cold place allowances amount to about 20% of monthly pay, if the city allowance is mid level (7% of the main pay). City allowance according to category of place of work is the largest difference among various payment conditions of allowances.

(2) Pay structure before the change

The other aspect relating to the change in the payment system is the pay structure. This consists of two aspects: grade structure and pay bands. The grade structure in Company JT1 is a person grade system as a form of 'qualification grade based on job-related ability' (*shokunou shikaku toukyu*). The qualification grade for managers consists of five grades from management grade 5 (*kanri 5 kyu*) to management grade 1 (*kanri 1 kyu*) (grade 5 being the lowest and grade 1 the highest). Relationships between the management grade and position or job are as follows. Management grades 4 and 5 = *kachou* (line managers of a section or small department⁸⁵) and *chousayaku*

⁸⁴ See section 3.2.in chapter 3 or Appendix IV about *kijungai chingin*.

⁸⁵ Section is translated from *ka*, department is translated from *bu* and division is translated from *jigyoubu* and *jigyō honbu* used in Company JT1 *Jigyō honbu* are the highest level in the organisational hierarchy. *Jigyoubu* is often a lower level than *jigyō honbu* and is often a unit within *jigyō honbu*. *Jigyoubu* is also used for the highest organisational level as the same level as *jigyō honbu*, but smaller than *jigyō honbu*. *Bu* is a lower level than *jigyō honbu* and *jigyoubu* and a unit within *jigyō honbu* or *jigyoubu*. *Bu* is also used as the name for a cost centre such as the financial and HR departments. *Ka* is a lower level than *bu*, and *ka* is a unit within *bu*.

(management grades 4 and 5 other than line managers). Management grades 1, 2, and 3 = *buchou* (line manager of department or division), *shukan* (approved specialist) and *tantou buchou* (employees in management grades 1, 2 and 3 other than line managers and specialists). *Buchou* (line managers appointed among management grades 1, 2 and 3) is a higher position than *kachou* (line managers appointed among management grades 4 and 5). That is, *kachou* reports to *buchou*.

As indicated above, Company JT1 divides employees into three types for management grades 4 and 5 (*kachou* and *chousayaku*), and three types for management grades 1, 2 and 3 (*buchou*, *shukan* and *tantou buchou*). The reason why Company JT1 divides management grades 4 and 5 into two types and management grades 1, 2 and 3 into three types is as follows. As management grades 1, 2 and 3 are higher grades, career directions of employees in these grades are more likely to have been decided than career directions of employees in management grades 4 and 5. For example, selection for line managers and approval for specialist skills are more likely to have finished for management grades 1, 2 and 3. Among the three types in these grades, *buchou* is line manager, *shukan* is an employee approved as having a high level of skills for their own areas, and *tantou buchou* is neither selected as a line manager nor approved as having a high level of specialist skills. In other words, *tantou buchou* tend to be employees not selected as line managers or specialists. However, this is a general tendency, and not all *tantou buchous* are necessarily unselected employees; some are in temporary positions of *tantou buchou* for organisational reasons and may be appointed to line manager positions in the future.

On the other hand, the career directions of employees in management grades 4 and 5 are less unlikely to have been decided than those in management grades 1, 2 and 3 and selection for line managers and specialists approved as having high skills is less likely to be finished. Therefore, *kachou* is a more temporary appointment to line manager positions than *buchou*. Other employees (*chousayaku*) who are currently not appointed to line manager positions have greater opportunities for future appointment as line managers than *tantou buchou*. Furthermore, as approval of specialist skills is less likely to be finalised for management grades 4 and 5 than management grades 1, 2 and 3, specialist types such as *shukan* are not set for management grades 4 and 5. Therefore, management grades 4 and 5 are divided only two types -- *kachou* (line manager) and

chousayaku (non-line manger).

There are some problems for *tantou buchou* and *chousayaku* in terms of discrepancies between their grade level and their contribution levels, because job levels and contribution levels for some *tantou buchou* and *chousayaku* are much lower than their grade levels. For example, the three highest qualification grades in non-manager grades among seven non-manager grades can be appointed to *kachou dairi* (substitution of *kachou*). Further, there are non-managers who substantially work as *kachou* despite their formal position as *kachou dairi* and their qualification grade levels as non-manager grade (this discrepancy between job and contribution levels, and the qualification grade levels will be demonstrated in profiles of employee interviewees in section 6.6.8). The main reason for this large discrepancy is due to employees having been promoted to a management grade a long time ago. Current practices of promotion to management grades are highly selective as will be described below. However, in the past promotions to management grades were relatively easy. Such promotion practices create the large discrepancies described above, although there are other reasons such as when competent employees were promoted to management grade, their career development after the promotion reached a plateau.

Although Company JT1 recognised that it was a problem, it was at an acceptable level. However, after the acquisition of the UK mobile phone firm, foreign managers dispatched from the UK parent firm perceived that this was highly problematic and required changing. However, specific changes started after the case study. Therefore, only the direction of the change after the acquisition will be mentioned in the final part (section 6.6.9).

The qualification grade system has another aspect -- promotion of the qualification grade. The single most influential factor linked to the qualification grade promotion is adding up of appraisal ratings. The rating categories were S, A, B, C and D (S is the highest and D is the lowest). The rating categories were transformed to number points as follows; S = 4, A = 2, B = 0, C = -1, D = -2⁸⁶. Criteria for grade promotion to the next higher qualification grade are set for each qualification grade. If employees reach the

⁸⁶ Although Company JT1 did not change the qualification grade structure and qualification grade promotion system, it changed rating categories when it changed the payment system from S, A, B, C and D towards S, A, B+, B, C and D as will be described later. Therefore, past tense is used in the text for the rating categories.

number of points set as the promotion criteria, they are promoted or become candidates for promotion. Among the various steps in qualification grade promotions, promotion from a non-management to a management grade is considered as the most significant. Therefore, this promotion step is the most difficult and the selection rate is the smallest. Every year about 150 employees become promotion candidates for management grade due to attaining the required rating points and the recommendation of line managers. Corporate HR assesses these 150 candidates mainly on the basis of past appraisal results. As a result, the number of candidates is reduced to about half. After the selection by corporate HR, a pencil and paper test and promotion interviews by several senior managers are undertaken. About 20 employees are finally promoted to management grade every year.

The other key aspect of the pay structure is pay band (the shape of the pay structure). This concerns the 'box type' popular in the UK or pay table (*chingin hyou*) popular in Japan as discussed in section 3.3.4 in chapter 3. The pay structure of Company JT1 was based on a pay table before the change. Therefore, there was no concept of a pay range for each qualification grade (pay grade is equivalent to the qualification grade). Minimum pay levels were determined but there were no maximum pay levels in the pay table. Maximum pay levels for each qualification grade changed every year due to *base-up* and *teiki shoukyu* (regular pay increases) as indicated in section 3.3.5 in chapter 3. For example, *gou* 15 and ¥ 400,000 are the maximum levels in management grade 4 in this year, but the maximum level would increase to *gou* 16 and ¥ 410,000 in the next year, if employees with maximum pay levels were not promoted to a higher grade.

6.6.4 Payment system for managers after the change

Company JT1 changed the payment system for managers in 1999 as a specific policy in order to achieve the establishment of an output performance-based payment system. Contents of the change and reasons for the change will be discussed in relation to elements of monthly pay and pay structure.

(1) Elements of monthly pay after the change

The new elements of pay, contents (or change) of each element and methods of pay increase/decrease for new grade-related pay (*shikakukyu*) and job-related ability and

performance pay (*shokunou seikakyu*) are as follows.

Elements of monthly pay after the change

1. *Kijunnai chingin*

1.1 New grade-related pay (*shikakukyu*)

Amounts of the new grade-related pay are differentiated by ratings in *nenkan sougou hyouka* (yearly general appraisal) and sub pay bands within one pay band. The sub pay band system was discussed in 6.3.1 and the relationship between ratings and sub-pay bands, and pay increase/decrease rates were shown in table 6-9 in section 6.4.2. (sub pay band system and relationships between ratings and sub pay band, and pay increase rates will again be discussed in the next 'pay structure' section).

1.2 Housing allowance (*juutaku teate*)

No change

2. *Kijungai chingin*

2.2 Job-related ability and performance pay (*shokunou seikakyu*)

Amounts of *shokunou seikakyu* are determined by ratings in *nenkan sougou hyouka* (annual general appraisal). Fixed amounts of money are set for each management grade and each rating category. Table 6-10 in section 6.4.2 indicates the fixed amounts of money for each management grade and each rating category. Amounts of money indicated in table 6-10 are pay levels in 2001 paid monthly (from April 2001 to March 2002). Amounts of money for each grade and each rating category are reviewed annually.

2.3 Adjustment pay (*chouseikyu*)

Adjustment pay is paid to employees whose monthly pay levels were reduced by the change in the payment system of supplements. Company JT1 expects that individual pay levels will be adjusted to the pay levels for all employees without adjustment pay within a few years. Company JT1 plans to review the situation of pay adjustment for all employees five years later, and plans to abolish the adjustment pay.

2.4 City allowance (*toshi teate*)

Reduced

2.4 Cold place allowance (*kanreichi teate*)

Reduced

Compared with elements of monthly pay before the change, the largest difference is the abolition of age-related pay. The dependence allowance was also abolished, and the city

and cold place allowances were reduced. As a result, the proportion of the cost-of-living allowance against total monthly pay decreased from about 20% to less than 10%. The budget for the abolished age-related pay and cost-of-living allowances was transferred to a budget for new grade-related pay and *shokunou seikakyu* (job-related ability and performance pay).

There are two main purposes of change in the elements of monthly pay. One is to expand the proportion of monthly pay determined through appraisal ratings. Before the change, only grade-related pay was linked to appraisal ratings. After the change, the new grade-related pay and *shokunou seikakyu* (job-related ability and performance pay) are linked to appraisal rating. Before the change, manager allowance, which was linked to management grade, was linked in appraisal ratings in the long term, because qualification grade promotion was mainly determined by adding up appraisal rating points. Therefore, grade-related pay and manager allowance were related to appraisal rating before the change. However, the proportion of new grade-related pay and *shokunou seikakyu* (job-related ability and performance pay) after the change against total monthly pay is larger than the proportion of grade-related pay and manager allowance against total monthly pay before the change.

The other purpose of change is to make larger pay differences according to appraisal ratings. Before the change, grade-related pay was linked to appraisal rating. However, the difference made by the appraisal rating was small. The range of the grade-related pay increase was from ¥ 4,500 to ¥ 14,000 differentiated by appraisal ratings and qualification grades. The method used for increasing pay is by increasing *gou*. Pay differentials between each *gou* differs between the qualification grades. The smallest pay differential among management grades was management grade 5 (lowest management grade) and the pay differential between each *gou* in management grade 5 was ¥ 1,500. The largest pay differential among management grades was management grade 1 (highest management grade) and the pay differential between each *gou* in management grade 1 was ¥ 2,000. There were 5 rating categories: S, A, B, C, D (S being the highest rating and D the lowest). How many *gous* were increased was determined by the rating category in the appraisal. The relationship between rating category and number of *gou* increases are as follows. D = 1 *gou* increase, C = 2 *gous* increase, B = 3 *gous* increase, A = 4 *gous* increase and S = 5 *gous* increase. Furthermore, a D rating (the lowest rating) hardly occurred. Therefore, the pay increase for the

highest rating (S rating) was ¥ 10,500 and the pay increase for the practically lowest rating (C rating) was ¥ 6,000 in management grade 5. Consequently, differences in pay increase between the highest and the practically lowest ratings were only ¥ 4,500. After the change, the influence of appraisal ratings became much greater for the new grade-related pay and *shokunou seikakuyu* (job-related ability and performance pay) as indicated in table 6-9 and table 6-10 in section 6.4.2.

Many employees' pay levels decreased with the change in the payment system. Pay levels for employees whose pay levels were increased were immediately increased, but employees whose pay levels decreased were paid an adjustment allowance as described in 'elements of monthly pay after the change'. Company JT1 plans the abolition of the adjustment allowance five years later. Furthermore, pay decreases continuously occur by ratings. Therefore, Company JT1 thinks that consistency between contribution levels and pay levels is achieved continuously.

(2) Pay structure after the change

Company JT1 did not change grade structure, because it was considered less problematic than the pay bands. So Company JT1 changed only the pay bands. The direction of change was from pay table (*chingin hyou*) to a pay structure in which pay bands have pay ranges with minimum and maximum pay points (this thesis calls this type of pay structure the 'box type'). The reason for the introduction of the box type pay structure is to set maximum pay points. As there was no concept of a maximum pay point in the pay table, pay levels increased with no limitation, even though employees stayed in the same grades for a long time. Company JT1 perceived this as one of the causes of seniority-related pay increases. The reasons for introducing the box type pay structure were to reduce seniority-related pay increases and to create consistency between contribution levels and pay levels.

Further, Company JT1 set five sub pay bands within one pay band. In the new pay band system, the higher the sub pay band, the lower the pay increase rate for the same rating categories. In addition, as the pay decrease system for low ratings was introduced, the higher the sub pay band, the higher the pay decrease, if employees take low ratings. The introduction of the sub pay bands decreased the pay increase rate for employees staying in the same grade for a long time. The reason for introducing this sub pay band system

is the same as the reason for introducing the box type pay structure. Additionally, the introduction of sub pay bands is influenced by western practice. For some zones in which the pay increase rate differs between the zones is a popular practice in western countries. HR practitioners in Company JT1 gathered information about western HR practices from consultancy firms and other Japanese firms which had introduced this type of pay band.

6.6.5 Appraisal

(1) Major changes in the appraisal system

The appraisal system also changed in relation to changes in the payment system. There are two main reasons for the change. The first is the establishment of more objective and consistent measurements of individual contributions (output performance and input performance). Company JT1 thought that if pay differentials due to appraisal rating was not large, employees would not pay great attention to the ratings. However, if pay differentials due to ratings were large, employees were more likely to focus on the ratings, and on why and how the ratings were decided. Therefore, changes to the appraisal system were necessary with the payment system changes, creating large differences due to appraisal ratings. Therefore, changes to the appraisal system were mainly derived from employees' reactions and their retention and motivation reasons.

The second purpose for the change to the appraisal system was to give more emphasises to output performance than input performance. There were three reasons for this. Input performance tended to be related to seniority-related pay due to the difficulty in assessing input performance. Assessment of input performance tended to be more subjective due to the difficulty in assessing input performance, and subjective judgement was unfair. Current output performance is more important than input performance. Although how performance is achieved should be considered in the appraisal, actual performance is more crucial to achievement of the firm's business objectives.

There were five main directions for the changes made to the appraisal system. The first was disclosure for rating items and rating criteria. Company JT1 thought that the disclosure was required more now than in the past, once pay differentials due to

appraisal ratings become larger.

The second was a change for the MBO scheme towards a more standardised and consistent way. One MBO cycle spans one year. It starts in April and ends in March. In April, objectives for the next year are set through discussion between line managers and employees. Before the discussion, the employee submits self set objectives. At the end of the year (next April), the line manager and the employee discuss the degree of achievement of the objectives set a year ago, and the line manager decides the ratings of the performance appraisal. Formal appraisal meetings are set twice a year: end of year meeting and mid year meeting. In the mid year meeting, the degree of achievement of objectives and other issues related to the MBO, including changes to the objectives, are discussed.

MBO and the link between MBO, the performance appraisal and pay are not new for Company JT1. Company JT1 implemented the MBO scheme linked to performance appraisal and pay about ten years ago. However, in practice the MBO scheme was not well standardised. For example, types of objective were differentiated by individual line managers and members. For instance, some employees set mostly development objectives and line managers mainly used these objectives to increase overall ratings. That is, these line managers generally decided on good ratings for development objectives and these good ratings contributed to increase overall ratings. As decisions for development objectives are more likely to be subjective than output performance, line managers could use the development objectives to improve overall ratings, even though employees' job-related abilities were not well developed. Although Company JT1 had implemented another evaluation scheme relating to development, it delegated decision making about whether or not and/or to what extent development objectives were used in the MBO scheme linking to pay to line managers. This created divergence on whether or not and to what extent development objectives were used in the MBO scheme between individual line managers. Company JT1 considered that a more standardised MBO scheme was needed across the organisation. This is because consistent decisions for appraisal become more important once pay differentials by appraisal ratings become larger. As a result, objectives are limited to output business performance and line managers are required to quantify measurements as much as possible.

The third direction was a change in input performance appraisal. Ability appraisal which assesses job-related abilities based on 'criteria relating to job-related abilities' (*shokunou youken*) was used before the change. However, 'criteria relating to job-related abilities' have two problems. One is that such criteria are general. As a result, there were few recognisable differences in the criteria set between each grade. Furthermore 'the criteria relating to job-related abilities' had not been reviewed for a long time (around ten years). The criteria did not relate well to the current job contents. Consequently, line managers hardly used 'the criteria relating to job-related abilities' (*shokunou youken*) in appraisal decisions. It is seen that 'the criteria relating to job-related abilities' had already been substantially abandoned at the time.

These problems in 'the criteria relating to job-related abilities' became more serious once pay differentials became larger due to appraisal ratings for input performance. Company JT1 introduced competency profiles and replaced competency profiles with 'the criteria relating to job related abilities' as the criteria to assess input performance. Competency profiles were based on behaviours related to high output performance. Information on behaviour of high output performance was gathered from interviews with employees who had been awarded good ratings continuously and/or on the recommendation by heads of divisions, and interviews with top management to establish the behaviour they considered as necessary to achieve business objectives. Company JT1 thought that competency profiles were more specific than 'the criteria relating to job-related abilities'.

The fourth direction was a change of rating categories from 5 steps as S, A, B, C and D (S being the highest and D the lowest) to six steps as S, A, B+, B, C, and D. There were two main reasons for this, one being the reduction of a central tendency and the other to decrease the S rating. The S rating was used only for very high levels of contribution (in both output and input performance). Before the change, the distribution rate of each rating category was S = 15%, A = 35%, B = 35%, C = 15%, D = hardly rated. After the change, the distribution rate of each rating category became S = 5%, A = 20%, B+ = 25%, B = 35%, C = 15%, D = hardly rated. Forced distribution was introduced by HR (both corporate and divisional) both before and after the change.

The fifth direction was to strengthen the influence on pay determination by ratings based on output performance rather than input performance. Reasons for this change

have been discussed above. One specific method used to shift the relative emphasis from input to output performance is a change to the types of appraisal linked to pay. Before the change, there were two types of appraisal linked to pay: performance appraisal (*gyouseki hyouka*) which assessed output performance, and ability appraisal (*nouryoku hyouka*) assessing input performance. The performance appraisal was linked to the MBO scheme. Although the title of the appraisal was 'performance appraisal', the appraisal included input aspects such as development as described above. The frequency of the performance appraisal was twice a year, and the frequency of the ability appraisal was once a year. The performance appraisal was linked to biannual regular bonuses and the ability appraisal was linked to grade-related pay in grade-related pay within monthly pay. After the change, there were also two types of appraisal linked to pay: performance appraisal (*gyouseki hyouka*) and competency appraisal (replacing ability appraisal). The performance appraisal was held twice a year and the competency appraisal once a year. The performance appraisal was linked to biannual regular bonuses. The annual general appraisal (*nenkan sougou hyouka*) which mixes the performance appraisal (2/3 weighted) and the competency appraisal (1/3 weighted) was linked to the new grade-related pay and 'job-related ability and performance pay' (*shokunou seikakyu*) within monthly pay. Thus, the influence on pay of the performance appraisal became greater. Before the change only ability appraisal was linked to monthly pay, but after the change, not only the competency appraisal but also the performance appraisal was linked to monthly pay. Furthermore, the degree of influence of the performance appraisal (2/3 weighted) was larger than the degree of influence of the competency appraisal (1/3 weighted).

(2) Competency appraisal

Because the competency appraisal was new, it is summarised here. Competency profiles for managers were divided into three areas: competency profiles for management grades 1, 2, and 3, competency profiles for management grades 4 and 5 for sales employees, and competency profiles for management grades 4 and 5 for non-sales employees. Company JT1 changed the categorisation for competency profiles from 'the criteria relating to job-relating abilities' (*shokunou youken*) used in the old system. The old system criteria fell into 5 categories according to five management grades. However, this number was too large. As a result, there were few recognisable differences between each grade. This became one of the problems for 'the criteria relating to job-related

abilities'. In order to solve the problem, the categories were reduced to three: management grades 1, 2 and 3, management grades 4 and 5 for sales employees, and management grades 4 and 5 for non-sales employees. The reasons for the categorisation are as follows. The level of contribution is generally different between management grades 1, 2 and 3 and management grades 4 and 5. For example, line managers in management grades 1, 2 and 3 (*buchou*) have higher responsibility than line managers in management grades 4 and 5 (*kachou*), since line managers (*buchou*) are appointed as division or department heads and line managers (*kachou*) are appointed as small department or section heads, and *kachous* usually report directly to *buchous*. Therefore, competency profiles that indicate required and/or desirable behaviours should be different between management grades 1, 2 and 3, and management grades 4 and 5. Regarding the division between management grades 4 and 5 for sales employees, and management grades 4 and 5 for non-sales employees, the required and/or desirable behaviours are different between sales and non-sales. The reason why only management grades 4 and 5 are divided by sales and non-sales (with no such division for management grades 1, 2 and 3) is that management grades 4 and 5 require more skills, knowledge and behaviours relating to their own business areas, whereas management grades 1, 2 and 3 more require skills and behaviours as general managers.

6.6.6 Differences in payment system for non-managers from managers

The payment system for non-managers changed in 2000. The purposes and directions of the changes in the payment system are the same as those for managers. The new payment system for non-managers was almost the same as the payment system for managers as discussed above. Yet, there were some differences which, except for very minor ones, are pointed out here.

There are three main differences between managers and non-managers. The first concerns elements of monthly pay. There are two types of job-related ability pay -- grade-related pay (*shikakukyu*) and job-related ability and performance pay (*shokunou seikakyu*) -- for managers. However, job-related ability pay for non-managers only consists of *shikakukyu* and there is no *shokunou seikakyu*. The reason for it is that *shokunou shikakukyu* was transferred from the former manager allowance (*kanrishoku teate*), and there was no manager allowance for elements of monthly pay for non-managers. Another reason for this is that *shokunou seikakyu* is more differentiated

by rating categories than grade-related pay for managers. Therefore, *shokunou seikakyu* has stronger appraisal-related pay characteristics than grade-related pay. Company JT1 thinks that managers' pay should be more related to individual contribution than non-managers' pay. This is another reason for no existence of *shokunou seikakyu* for non-managers.

The second is regarding the qualification grade promotion system. The basis of the qualification grade for non-managers is the same as for managers -- i.e. 'qualification grade based on job-related ability' (*shokunou shikaku toukyu*). There are seven grades for non-managers: A5, A4, A3, A2, A1, S2 and S1 (A5 is the lowest and S1 is the highest grade). The promotion method for non-managers is the same as for managers. That is to say, criteria are set by adding up rating points. However, there is one additional criterion -- years of service for each qualification grade. The criterion for years of service as minimum years of service for each step of the qualification grade promotions is set as follows. Three years for qualification grade promotion from grade A5 to grade A4, from grade A4 to grade A3 and from grade A3 to grade A2, two years for qualification grade promotion from grade A2 to grade A1, from grade A1 to grade S1 and from grade S1 to grade S2.

The reason why Company JT1 sets years of service as the criterion for the qualification grade promotion only for non-managers lies in the development aspect of non-managers. Company JT1 thinks as non-managers tend to be young, their skills and knowledge are more likely to be developed according to years of service than managers. This closer relationship between development and years of service in non-managers can be regarded as non-managers needing years of service to develop their skills and knowledge more than managers. Even high potential employees cannot acquire skills and knowledge without experience. This is the reason for setting years of service as the criterion for non-managers only.

Years of service as the criterion for qualification grade promotion influence another aspect of the payment system. That is, the operation of the change of pay increase/decrease rates by sub pay bands is somewhat differentiated from for managers. This is the third difference between managers and non-managers. As indicated earlier, five sub pay bands are set within one pay band. The higher the pay bands, the lower the pay increase if employees have the same rating categories. Moreover, as the pay

decrease system was introduced for low ratings, the higher the pay bands, the higher the pay decrease for low ratings. However, application of this system to non-managers in the same manner is considered unfair. This is because the years of service criterion for the qualification grade promotion are set: even when employees receive the highest ratings, they must stay in the same grade for at least the minimum years of service set as the criterion. Therefore, the pay increase and decrease system relating to sub bands is not applied to all non-managers uniformly. Accordingly, the policy of pay increase rates for the lowest sub pay band (this means the highest pay increase rates among five sub pay bands) is applied to employees within the minimum years of service set as the promotion criterion.

Furthermore, HR considers an individual's situation in applying sub pay bands and pay increase/decrease rates by each sub pay band for non-managers. HR practitioners think that considering the individual situation is particularly important for high level non-managers. This is because employee profiles in this category are quite different. Some are young competent employees with new skills and some are employees who cannot be promoted to the management grade and remain in high levels in the non-management grade for a long time. The latter type is generally middle- and old-aged employees (although there is a tendency for non-managers to be young, not all of them are). Pay practices should therefore be differentiated according to individual situations, particularly for employees in this category.

6.6.7 Differences of payment system among non-managers

Company JT1 also differentiates between high and low level non-managers. The main difference between them is that output performance is emphasised more for high than for low level non-managers. Instead, input performance takes relatively high priority for low level non-managers. One reason for the difference is that low level non-managers are more likely to be in the development stage, therefore their skills and knowledge are more likely to increase as they acquire more experience. That is, seniority-related pay in terms of years of service is rationalised to some degree. Emphasis on input performance is more likely to result in seniority-related pay. Hence, relative emphasis on input performance is rationalised to some degree. Another reason is that discretion or delegated decision making power is very small for low level non-managers. Furthermore, job contents are unlikely to be fixed, because these non-managers are in

the initial stage of career development. Accordingly, the level and contents of their output performance are differentiated by the judgement of their line managers, such as deployment of task contents and task levels. In this situation, making large pay differentials due to assessment of output performance is unfair. Considering input aspects that tend to result in seniority-related pay is rationalised to some degree.

There are principally two specific methods to reduce the emphasis on output performance. One is to remove the link between the MBO scheme and the performance appraisal. Although the MBO scheme is operated for low level non-managers, measured output performance in the MBO cycle does not link with the performance appraisal. Line managers use the output performance measured through the MBO scheme as a reference to the performance appraisal. The other is the use of *jyoui kouka* that assesses the general attitude of employees, such as seriousness and eagerness in their jobs, or cooperation with other employees. The *jyoui kouka* is included in the competency appraisal and line managers usually use ratings of the *jyoui kouka* to increase overall ratings in the competency appraisal.

These differences in a type of link between MBO and performance appraisal that include *jyoui kouka* increase ratings of low level non-managers. Although forced distribution is used for low level non-managers, distribution rates are somewhat different for low level non-managers. In other words, a distribution rate shifts towards higher rating categories. For example, distribution rates for high ratings such as S and A are 5–10% greater among low level non-managers than managers and high level non-managers, and a C rating (practically the lowest rating) hardly ever occurs. Company JT1 considers that encouragement is needed for young employees through relatively high ratings in order to develop their skills and knowledge. Individual contribution levels cannot be decided in the initial career stage, because their apparent contribution levels in the initial stage is largely differentiated by factors beyond their control, such as line managers and business requirements of the workplace. Therefore, the apparent contribution levels in the initial career stage include luck. Low appraisal ratings may cause unnecessary disappointment in young employees and this may lead to adverse effect on motivation and development.

6.6.8 Operation in pay review and appraisal

So far, the formal payment system has been discussed. The discussion now turns to the operation of individual pay determination. The author interviewed eight employees in order to gather information about the operation of pay reviews and appraisals. Before the contents of the interviews are discussed, profiles of the interviewees should be mentioned. Among the eight interviewees, two are line managers (appraisers) in management grades, two are non-line managers (non-appraisers) in management grades, two are line managers (appraisers) in non-management grades, and two are non-line managers (non-appraisers) in non-management grades. These interviewee profiles may demonstrate that qualification grades and actual jobs divergent. Two interviewees in a management grade are *chousayaku* (management grades 4 and 5, employees with non-management roles). Two interviewees in a non-management grade are *kachou dairi* (substitute of section manager, non-management grades A1, S1 and S2).

Regarding pay reviews, corporate HR decides individual pay levels, not line managers. Line managers indirectly participate in individual pay reviews through appraisal, but take no direct participation in the pay review. Moreover, line managers do not know individual pay levels of their staff, although line managers in management grades briefly captured pay levels for each qualification grade, because division heads explained approximate pay levels for each qualification grade when the payment system changed (1999 for managers and 2000 for non-managers). Therefore, line managers did not explain the reasons for the pay review result. Individuals, including line managers, learn the results of the pay reviews by letter from corporate HR, but they do not know the reasons for the decision, because there is no explanation about it.

As indicated, the individual pay is reviewed and decided by corporate HR in liaison with divisional HR in accordance with the formal payment system. Therefore, the appraisal process is focused upon here. Regarding the interview contents, interviews with line managers (appraisers) included both their roles as appraisers and appraisees.

There are two types of appraisal operated in Company JT1: the performance appraisal which assesses output performance, and the competency appraisal assessing input performance. All interviewees focused more on the performance appraisal among the two types of appraisal. For example, when the author asked about appraisal, she initially

used the word '*jinji kouka*' (this term includes all types of appraisal or all types of appraisal relating to judgement as discussed in section 3.3.6 in chapter 3). The interviewees often started to describe the performance appraisal, before the author clarified that she was asking about the performance appraisal and the competency appraisal separately. Furthermore, some interviewees even forgot about the competency appraisal. According to the interviewees, the reason why they focused more on the performance appraisal was due to the greater influence of the performance appraisal than the competency appraisal on promotion and pay.

Initially, MBO linked to the performance appraisal is discussed. The performance appraisal is linked to MBO for employees above grade A1⁸⁷ in non-management grades. Two interviewees are grade A2 and six interviewees are above grade A1 (including both management and non-management grades). Although there is no regulation for the link between the MBO and the performance appraisal, line managers can link the MBO and the performance appraisal for employees below grade A2. In fact, one interview with an A2 grade employee revealed that his new boss from the UK parent firm links the MBO and the performance appraisal.

The first consideration about MBO is whether or not particular objectives are the basis of output performance. Two interviewees in management grades do not set objectives and others set objectives as the basis of output performance. Whilst objective setting as the basis of measurement of output performance is required by the formal guideline, not all employees set the objectives. Among the interviewees who set objectives (or set their staffs' objectives as line managers), most interviewees expressed difficulty in setting objectives.

There are mainly two reasons for this difficulty: one is the difficulty in predicting the next six months' business requirements and the other is the difficulty in making quantitative measurements. Regarding the first point, the formal MBO meetings are set twice a year: end of year meetings and mid year meetings. In the mid year meeting, objectives are reviewed and changed if necessary. Therefore, the interviewees are set objectives for the next six months. However, as business changes quickly, it is difficult to set objectives for the next six months. For example, sales interviewees pointed out

⁸⁷ After April 2002, the performance appraisal was linked to MBO for all employees. However, at the time of the interview (from March to April 2002), the new MBO scheme had not yet started.

the difficulty in setting objectives under quickly changing customer requirements. However, in spite of this difficulty, interviewees discuss business objectives on a daily basis in line relationships, and frequently review and change their business objectives, often every month. The interviewees tend to divide objectives linked to MBO between HRM issues and business issues, and they tend to perceive objectives relating to HRM issues as paperwork.

A similar situation occurred for the second point of difficulty of quantitative measurement. For example, one interviewee dealing with constructing a new network pointed out that, as initial research for constructing a new network usually takes six months, quantitative measurement is difficult for the research period. However, he also said that he often discusses the process of the research, including to what extent the research has progressed and how it is proceeding with his boss and his colleagues. However, he expressed difficulty in measuring his achievement in MBO as HRM issues. This is because he hardly discusses and measures the process of his job in relation to MBO as an HRM issue. He seems to separate process management as daily business and MBO as an HRM issue, and seems to think MBO as an HRM issues is paper work to submit to the HR function.

Time for the appraisal meetings varies from 10 minutes to 1 hour, and between 15 minutes and 30 minutes in most cases. Therefore, time for the appraisal meeting is generally short. Preparation for the meeting is generally also short. Preparation equates to filling in the appraisal forms by the interviewees. No line managers gather information relating to output performance prior to the meeting (information gathering prior to performance review was sometimes pointed out by line managers in the UK case firms). The preparation mostly takes between 30 minutes to 1 hour for appraisees. The preparation equates to conducting a self appraisal, because appraisees must submit self appraisals prior to the meetings. For appraisers, the time varies from 0 to 5 or 6 hours, and between thirty minutes and one hour per appraisee in most cases. Appraisers who answered zero do not spend time on preparation, but they at least think about appraisees' output performance or contribution.

Contents of the appraisal meeting vary. One general tendency is that the appraiser points out strengths and weaknesses and does not mention their assessment of the appraisee's output performance or contribution levels (according to the interviewees the appraisal

meeting relating to the performance appraisal often includes input aspects). For example, one line manager interviewee said that his appraisees have both strengths and weaknesses, and points out specific points regarding strengths and weaknesses. But he does not mention his assessment for the appraisees' contribution levels. The appraisal meeting is similar to a career meeting, which is operated in a line relationship for development purposes and separated from the appraisal meeting for judgement purposes, from the perception of some interviewees. Alternatively, some line managers mention their assessment of the appraisees' contribution level. But they indicate only a general impression for the contribution levels and do not mention specific points. In other words, line managers make comments such as 'your work is generally good'. Among the interviewees who said that their appraisers tell them their assessment of their contribution level, none has been told that their work is generally bad. Regarding feedback, two interviewees (as appraisers) offered feedback regarding overall ratings during or after the meeting, and no interviewees (as appraisees) received feedback regarding their rating categories (line manager interviewees are both aspects appraisers and appraisees). Regarding agreement about the ratings, one line manager interviewee said 'probably yes, my members probably agree with the ratings', and one line manager interviewee said 'I do not know' among the two line manager interviewees who gave ratings feedback to their members.

According to the interviewees, the main reason why the interviewees (as both appraisers and appraisees) are unlikely to discuss assessment for specific output performance and/or contribution, is that they think that appraisers should understand the level of output performance and/or contribution through daily business. In other words, line managers think that they understand their members' output performance and/or contribution. Employees (both line managers and non-line managers) tend to think that their bosses should understand their output performance and/or contribution. Hence, they do not have a need to discuss these issues in the appraisal meeting. The main purpose of the appraisal meeting for most interviewees is that they are required to set the formal appraisal meeting by HR. Therefore, their attitude towards the appraisal meeting is not very serious. But the interviewees did not deny the meetings: reasons for this vary. Some mentioned that the meeting is a good opportunity for a one to one discussion, some that there are no strong reasons to deny it.

As described, the interviewees are unlikely to put a high priority on the MBO cycle

linked to the performance appraisal. One reason may be that line managers already understand their member's contribution through daily business as indicated above. Another reason may be that there were no large differences due to appraisal ratings, especially for low level non-managers, at least until recently. There are two main reasons why the author believes that there are no large differences due to ratings. One is a direct indication by low level non-managers interviewed (grade A2 level) that there are no large differences due to appraisal ratings among their age group, and by high level non-managers interviewed (grades A1 and S1) that there were no large differences due to appraisal ratings among their age group until a few years ago, although pay differentials recently became greater among their age group. The other reason why the author believes that there are no large differences due to ratings is the interviewees' psychological contract for pay as 'pay for age'. When the author asked the question 'do you know the pay levels of employees with similar jobs to yours in other firms in the same industrial sector?', two answered 'Yes, I know, because large firms in this industrial sector have almost the same pay levels for the same age groups'. Two answered 'Yes, I know, because I have heard about the current pay levels of ex-colleagues of a similar age as me who changed their jobs to other firms'. One answered 'I know pay levels of my age group in other Japanese telecom firms, because they are almost the same among the Japanese telecom firms, but I do not know the pay levels in overseas-owned telecom firms, because pay levels of my age group differ according to individual job contents or individual output performance'. These answers may demonstrate the psychological contract of the interviewees as 'pay for age'. This type of psychological contract may be formed because of the small pay differentials relating to the appraisal ratings.

Although the author found that there are small pay differentials due to ratings, the interviewees also commented on recent changes in pay determination, with interviewees in management grades commenting more strongly than interviewees in non-management grades on recent occurrences such as pay decreases. They said that pay decreases never occurred in the past, but the situation has changed in the last few years. Furthermore, Company JT1 firstly practiced grade demotion for managers in 2001. This influenced managers' perceptions of HRM practices in Company JT1. They believed that seniority-related reward would increasingly decrease in the future. Moreover, all interviewees recognised changes in the near future as discussed in the next section as a 'direction of future change after acquisition', although they did not

know specific contents. For example, they knew that KPIs (Key Performance Indicators) would be introduced in the financial year of 2002 and that the contents of the MBO scheme would change. Interviewees perceived that the MBO and the performance appraisal would be more important.

It is noted that the interviewees are generally not very keen on the MBO cycle and the appraisal meeting as described above: this is a general tendency. There are, of course, variations among interviewees. For example, one line manager interviewee is very serious and spends 5 or 6 hours preparing for the appraisal meeting for each appraisee. The main purpose for the preparation is to make notes about his assessment for his members' output performance and/or contribution, and specific points regarding the strengths and weaknesses of the employee. He said, 'I think the appraisal meeting is very important. The meeting gives us opportunities to see that the perception of an individual's contribution is not necessarily the same between managers and members. We can find different perspectives through discussion, and this can increase the member's contribution. Although my boss is not very serious about my appraisal and provides little feedback about my contribution, I want to give feedback regarding my assessment of my members' contribution'⁸⁸.

6.6.9 Directions of future change after acquisition

The final stage of the case study (from April to May 2002) captured some directions of future change after acquisitions by the UK mobile phone firm. Although some specific changes had already started in the final stage, most major changes had not yet been started. General directions or symptoms of the future changes were found, because HR could not decide on specific directions of the change. Some directions (although they are in the very initial stage) found in the case study are indicated here.

After the acquisition, four new agendas were set through discussion between managers from the parent firm and managers in Company JT1 (managers includes HR managers and general managers). The four agendas are: to create consistency between management jobs and pay levels, to establish a development system for specialists, to

⁸⁸ This line manager does not mention his assessment for appraisee's output performance or contribution levels. He only discusses particular strengths and weakness with his appraisees. His appraisees are only two. This may be the reason that he can take long time for preparation of the appraisal meeting per appraisee.

modify the HRM system to contribute to the development of the data communication business and to increase pay levels for employees relating to sales in order to motivate and retain them.

Concerning the agenda of 'creating consistency between management jobs and pay levels', foreign managers from the parent firm perceived large differences between management jobs and pay levels as the most problematic issue in HRM. As pay levels are determined according to qualification grades and not according to job or positions, large discrepancies between pay levels and management jobs can occur. For example, there are employees in management grades 1, 2 and 3 who do not have a management job. Therefore, an agenda of creating consistency between management jobs and pay levels was set.

'Creating consistency between management jobs and pay levels' generated the need for another agenda of 'establishing a development system for specialists'. Employees with a high level of specialist skills should be rewarded with pay levels as high as those for management jobs. The development of specialists is important for the business success of the firm. Another agenda of 'increasing pay levels for employees relating to sales' is related to establishing a development system for specialists. This is because employees relating to sales are categorised as types of specialists, and increasing motivation and retention through increased pay levels is one way to achieve the establishment of a development system for specialists relating to sales. The reason why sales and related areas are particularly emphasised is that the influence of these employees in establishing the data communication business is currently particularly strong. Further, this objective of establishing the data communication businesses created another agenda of 'establishing an HRM system to contribute to establishing the data communication business'.

The initial change was started in April 2002 according to these HRM agenda. The major changes are introduced here. The first is the introduction of functional competency profiles for sales and pre-sales SEs (system engineers). This is related to 'establishing a development system for specialists'. Company JT1 decided to create a HRM system divided by job families, and the creation of a function-related competency profile is the first step. The competency profiles for sales and pre-sales SEs was firstly developed, because sales and pre-sales SEs are particularly important in achieving the business

objectives as discussed above.

The second is a change of the MBO system towards the introduction of KPIs (Key Performance Indicators). Although Company JT1 used MBO to measure output performance, managers from the parent firm perceived that levels of quantification were low. Furthermore, the levels of objectives and assessment were different between divisions and line managers. Moreover, the link between organisational objectives and individual objectives tended to be weak. As a result, Company JT1 decided to introduce KPIs as more standardised indicators than past practices. Specific KPIs applied across the organisation were developed at the time of the case study. Company JT1 regards the precise and consistent measurement of output performance as the starting point for restructuring the payment system.

The third is related to the measurement of output performance and appraisal. That is, subjects of the MBO scheme linked to the performance appraisal were expanded to all employees (employees below grade A2 were excluded until March 2002).

The fourth is the abolition of *jyoui kouka*, which assesses the general work attitude such as seriousness and eagerness to work, and cooperation with other employees (*jyoui kouka* was applied to employees below grade A2 until March 2002).

The fifth is the setting of a 'high-risk and high-return course' and 'low-risk and low-return course' for the payment system. The former type has higher levels of pay based on individual contribution, especially output performance. The latter type has lower levels of pay. Pay levels are more stable in the latter type, but higher pay levels cannot be expected. Individuals can choose either the high-risk and high-return course or the low-risk and low-return course. Specific contents of the high-risk and high-return course, and the low-risk and low-return course had not been decided at the time of the case study.

The sixth is the introduction of a new cash based incentive scheme for sales-related employees. The new scheme is paid to such employees (sales personnel, pre-sales SEs and sales branch managers) taking above B+ rating (B+ is the third highest rating out of six categories). Relative levels of the incentive are five times for S rating (the highest rating) and three times for A rating (the second highest rating) compared with the B+

rating. Absolute amounts of money of the new cash based incentive depend on the firm's overall financial performance.

The HR function in Company JT1 decided the above changes after the appointment of a new CEO by the parent firm. It planned further changes, such as changes in the grade structure from a person-based to a job-based grade structure, reduction in the number of grades, and the division of the HRM system between line managers and specialists. At the time of the case study, specific methods for the change had not yet been developed (HR made the brief plan between January and March 2002) and the HR function intended to create new HRM system within one or two years.

However, the situation changed in April 2002, because the new CEO changed the reporting structure to create clear line relationships and clear divisions between line managers and non-line managers. The CEO ordered the abolition of *tantou buchou* (employees in management grades 1, 2 and 3 other than line managers (*buchou*) and specialists (*shukan*)). Former *tantou buchou* became *kachou* (line manager position corresponding to management grades 4 and 5) or *kachou dairi* (line manager position corresponding to non-management grades A1, S2 and S1 – these three are the highest three grades within the non-manager grades) or staff as position levels under the new reporting structure. Many employees in non-management grades were newly appointed to line management positions in the new reporting structure. Furthermore, the new CEO ordered that suitable qualification grade and payment systems should be created for the new reporting structure. In other words, the HR function was required to implement more radical and quick change than they had thought. HR immediately started the project in order to change the qualification grade and payment systems. However, as changing the grade and payment systems takes time, HR considered that the new grade and payment systems would be developed and implemented by the end of 2002 financial year. Nonetheless, HR had to adjust the qualification grade levels to the new position levels as soon as possible. HR planned to practice grade promotions and demotions in order to adjust to the new positions under the new reporting structure in July. Although grade promotions and demotions were usually decided in April, because HR could not deal with a greater number of qualification grade promotions and demotions, they decided to extend the qualification grade promotions and demotions to July.

As described, the HRM system in Company JT1 faced radical change at the time of the final stage of the case study. There were a lot of uncertainties at the time. Information on future change could not be gathered, because one HR practitioner quit and one HR practitioner was deployed to another division from among two HR practitioners as the main information providers in Company JT1 after the case study.

The case study in Company JT1 focused on the payment system and related issues. However, employment policy is discussed as the final consideration. This is because employment policy is closely related to the design of a payment system as discussed in chapter 3. Until spring 2001 (before the acquisition), Company JT1 did not particularly consider any changes to the employment policy towards a reduction in long term employment, although it perceived that a reduction of long term employment is the general direction taken in Japanese firms, and that it may change its employment policy towards a reduction of long term employment. Furthermore, Company JT1 considered that pay costs could be controlled by increasing and decreasing individual pay levels. Therefore, pay cost control by head count would not be needed until spring 2001. However, the employment policy might have slightly changed after the acquisition. For example, whereas Company JT1 did not use a voluntary turnover (*kibou taishoku*) programme before the acquisition, it did introduce it November 2001. One of the reasons for this is that Company JT1 considered pay control by head count to be necessary. However, employment policy did not clearly change at the time of the case study, because the new CEO and other top management had not established a clear employment policy.

6.7 Summary

This chapter described payment systems in the case firms in Japan. At first, recent changes of the payment systems were discussed in terms of elements of base-pay (*kihonkyu chingin taikai*), as the elements of base-pay have been changing in many aspects as a shift from the basic characteristics of the Japanese type of payment system identified in chapter 3. For instance, output performance has been increasingly focused upon and job factors were recently introduced in the majority of the case firms.

One of the most striking recent changes in payment systems is the creation of larger pay differentials using the results of appraisals, and attention is given to the appraisal system,

with emphasis on ways of linking appraisal and pay.

Further, the individual pay review process in the real setting was discussed. Results of appraisals are directly linked to pay increase/decrease rates in the Japanese case firms. Therefore, the appraisal process is focused on in the pay review process. As a result, the research found three significant aspects. The first is that the correlation between pay levels and contribution levels are not high. The second is that employees did not show low satisfaction and low motivation despite the low correlation between pay and contribution levels. The research revealed the reason to be employees' tendency to perceive that pay is related to age not to contribution. The third is that decision making for individual pay determination is centralised, because corporate HR decides pay increase/decrease rates, and because strong coordination power for appraisal is exercised by the HR department.

The final section of this chapter focused on the payment system in Company JT1. Why and how the payment system in Company JT1 has been changed was discussed in more detail. The next chapter will describe payment systems in the UK case firms.

Chapter 7: Description of payment systems in case study firms in the UK

7.1 Profiles of case study firms

Eight firms were studied in the UK. This chapter describes the payment systems in the case firms in the UK. Changing aspects are focused on in the description of the payment systems as in the Japanese case firms. Firstly, profiles of these firms are shown in table 7-1.

Table 7-1: Profiles of case firms in the UK

Case firm	Profile
Company BT1	The largest mobile phone network provider in the world market in terms of number of customers. It has been rapidly growing along with the rapid expansion of the mobile phone market. However, in the UK, the speed of market growth is decreasing due to saturation of the mobile phone market.
Company BT2	An international telecom firm operating in about 50 countries. Company BT2 focuses on B to B services through IP (internet protocol) networks, and has sold many business areas to concentrate on this field. However, the IP business has not expanded as much as expected, leading to a loss for Company BT2.
Company BF1	The second largest spirit firm in the world market. Recently, Company BF1 has been concentrating on its core businesses of spirits and fast food restaurants, although it used to diversify into many business areas including unrelated ones. It divested its pub operations as non-core business in order to concentrate its core businesses.
Company BF2	Established in 1997 by the merger of two UK food and drink firms. This merger created the largest spirit firm in the world. Since then, Company BF2 has been concentrating on its core business of spirits and beer. It is divesting other business areas such as food processing and fast food restaurants.
Company BF3	For a long time, the main business of Company BF3 was milk and other dairy products. It diversified into many areas including unrelated ones. However, recently it has been concentrating on convenience foods and has divested many areas including the milk business.
Company BR1	The top ranked supermarket chain in the UK, holding about 25% of the grocery market. Company BR1 is keen to invest in non-grocery businesses, other types of retail shops and overseas investments. Within the grocery business, Company BR1 is keen to develop its own-brand products,

	launching 200 new products annually.
Company BC1	Established in 1999 by merger of the UK and Swedish firms. The merger made this the fourth largest pharmaceutical firm in the world. After the merger, Company BC1 sold its agricultural chemical business and now concentrates on the pharmaceutical side.
Company BO1	The main business areas for Company BO1 are lubricants and specialty chemical products. The Company was taken over by the UK-owned multinational oil firm in 2000.

7.2 Organisation level of payment systems studied in case study firms

As discussed in chapter 5, the organisation level of payment systems studied is either corporate level (where one payment system is applied to all employees), or division level (where more than two types of payment systems are in operation). Amongst the eight case firms in the UK, one payment system is applied to all employees in Company BT1 and Company BT2. Therefore, the payment system studied is corporate level for these two firms. More than two payment systems are operating in the other six firms.

Where there is more than two payment system, the payment system studied is the one within dealing with the largest number of employees as discussed in chapter 5. According to this condition, payment systems for white-collar employees, who are not covered by collective bargaining and whose pay levels are determined through individual pay reviews, were selected for Company BF1, Company BF2, Company BF3, Company BC1 and Company BO1. The divisions included vary by firm, e.g. corporate head office, marketing and sales divisions, and research and development divisions. Manager levels in factories are also included in the payment systems studied. This category of employees is consistent with research subject discussed in chapter 1 that the research excludes collective aspect of pay such as collective bargaining.

In addition, these firms suggested studying the payment system for white-collar workers if the research is to focus on strategic issues such as the link between organisation strategy and HRM/pay strategies. They suggested that if the research is to focus on industrial relations issues on each site, investigation of the payment systems for blue-collar workers would be advisable. The case firms in Japan are now changing their payment systems due to a change in organisation and HRM strategies rather than as a response to industrial relations, as will be discussed in the next chapter. The objective of

the research is to address the change in Japanese payment systems through comparison with UK payment systems. Therefore, the focal point of the UK side should be in accordance with the focal point of the Japanese side. Hence, the payment systems studied in the research are those which are characterised by close links with organisation strategy. This is condition of the 'important payment system' discussed in chapter 5.

Although the largest group of employees within Company BR1 is that of hourly paid workers who work for retail stores, the payment system for annual salary workers is studied. According to the interviewees within Company BR1, this is because this payment system is more closely linked to organisation strategy and because pay increases of hourly paid workers are determined through collective bargaining. Annual salary workers in Company BR1 are not covered by collective bargaining and their pay levels are determined through individual pay reviews, as within the other five firms. Company BT1 and Company BT2 do not recognise trade unions as pay bargaining bodies and there is no collective bargaining for pay determination. Within these two firms, individual pay levels are determined through individual pay reviews as within the other six case firms. Consequently, the research is limited to payment systems where pay levels are determined through individual pay reviews.

The author recognises that the degree of difference between white-collar workers and blue-collar workers is one of the most significant differences between Japan and the UK. UK researchers (Oliver and Wilkinson 1992, Winfield 1993, Peck and Stone 1993) point out the widespread use of appraisals and IPRP for blue-collar workers, as well as white-collar workers, as characteristics of the Japanese HRM system. Japanese researchers (Kawano 1990, Koike 1993, 1994, 1999, Mitani 1997) have discussed the small differences in payment systems between blue-collar workers and white-collar workers, and the reasons for it. In fact, this current research has found that the UK case firms have a larger difference in payment systems between blue-collar and white-collar workers than the Japanese case firms. The research refers to payment systems for blue-collar workers in order to capture the whole picture of payment systems in the case firms. However, payment systems for blue-collar workers are not the focus of this research.

7.3 Elements of base-pay

In the Japanese case firms, base-pay is often made up of various independent units of pay (*heizongata chingin*). However, there are no such units within base-pay in the UK case firms. There are two types of 'elements of base-pay' (*kihonkyu chingin taikei*) in Japan. One type constitutes independent units within base-pay. The other type influences base-pay levels and does not form independent units within base-pay. The former is *heizongata chingin* and the latter is *tanitsugata chingin*⁸⁹. There is an equivalent concept for the latter type in the UK, but not for the former type. The main elements considered in the determination of individual base-pay in the UK case firms are summarised in table 7-2 below.

Table 7-2: Elements considered within determination of individual base-pay

Case firm	Elements considered in the determination of individual base-pay
Company BT1	Market rate for the job, output performance, competency (behaviour) ¹ , internal relativity ²
Company BT2	Market rate for the job, output performance, competency (knowledge, skills and behaviour) ¹ , internal relativity ²
Company BF1	Market rate for the job, output performance, competency (behaviour) ¹ , internal relativity ²
Company BF2	Market rate for the job, output performance, competency (skills, knowledge and behaviour) ¹ , multiple feedback (360 degree feedback), internal relativity ²
Company BF3	Market rate for the job, output performance, competency (behaviour) ¹ , internal relativity ²
Company BR1	Market rate for the job, output performance, internal relativity ²
Company BC1	Market rate for the job, output performance, internal relativity ²
Company BO1 ³	Market rate for the job, output performance, experience, skills, knowledge, internal relativity ²

¹ Although output performance and competency (input and process) are shown as separate factors in table 7-2, there is no strict division between output performance and competency in the UK case firms. This will be discussed in the 'competency' section.

² Internal relativity includes comparison between jobs and between employees.

³ Information about competencies was not gathered from Company BO1.

Since the case firms consider the three factors of job, market and person as shown in

⁸⁹ *Heizongata chingin* and *tanitsugata chingin* are described in section 3.3.1 in chapter 3 and Appendix IV.

table 7-2, the elements considered within the determination of individual base-pay are discussed using these three factors.

7.3.1 Job factor

All case firms look at the job factor in two ways; the market rate for the job and the internal relativity of pay between jobs. According to most case firms, the most important factor for individual pay determination is either contribution levels⁹⁰ or market rates for jobs. The general tendency in the case firms is that contribution is more likely to be focused on at the senior job level and pay levels for junior jobs are more linked to job content, since in senior level jobs, the content is not clearly defined and is more likely to be changed. As described, even though other factors can also be influential factors, the job is the basis for deciding base-pay in the case firms.

(1) Job evaluation

Job contents such as tasks, responsibility and the skills and knowledge required to perform the job are specified. As a result, the relative values of jobs within an organisation are determined through job evaluation. Base-pay rates which are attached to jobs are determined according to the relative value within the organisation. This is the basic method used to determine base-pay in the UK (Armstrong and Murlis 1998, Torrington and Hall 1994, 1998, Bratton and Gold 1999). This method is consistent with practices in all UK case firms that decide the relative value of jobs using various methods of job evaluation. However, many case firms recently changed their job evaluation methods. The current methods are summarised in table 7-3.

⁹⁰ 'Contribution' is used to express both input and output aspects of the person factor as discussed in chapter 2.

Table 7-3: Job evaluation methods in case firms

Case firm	Job evaluation method
Company BT1	Job value is determined based on a brief job description ¹ . Changed from point factor scheme more than 10 years ago
Company BT2	Job value is determined based on a brief job description ¹ . Changed from point factor scheme about 10 years ago.
Company BF1	Job value is determined based on a brief job description ¹ .
Company BF2	Job value is determined based on a brief job description which focuses on competencies. One of the previous firms changed its job evaluation method from point factor scheme to the current scheme in 1996. Company BF2 adopted this method after its merger in 1997.
Company BF3	Point factor scheme.
Company BR1 ²	Plan to change the job evaluation method from 2002 from point factor scheme to determining job value based on a brief job description ¹ .
Company BC1	Job value is determined based on a brief job description ¹ . Changed from point factor scheme in 2000.
Company BO1	Point factor scheme.

¹ Brief job description includes information such as main tasks, reporting levels, levels of responsibility, experience, skills and knowledge.

² The job evaluation method was in the process of change at the time of the case study for Company BR1 in 2000.

From table 7-3, it can be seen that job evaluation methods have changed or are changing in the case firms. Around 1990, six out of the eight firms used the point factor scheme, compared to only two firms today. Under the point factor scheme, levels of jobs or job sizes are indicated by points. Jobs are graded using points and pay levels are basically attached to the point of each job. However, many case firms have abolished the point factor scheme. These case firms refer to new evaluation methods such as market-driven pay and non-analytical job evaluation. New methods of job evaluation are considered to be job ranking⁹¹ or job classification⁹² (non-analytical job evaluation) plus market pricing.

There are various reasons why many of the case firms abolished point factor schemes. Specific reasons and situations in which they are generated in the case firms are described using examples of Company BR1 (retail) and Company BT1 (telecom) as follows.

⁹¹ Definition of job ranking is provided in section 2.2.2 in chapter 2.

⁹² Definition of job classification is provided in section 2.2.2 in chapter 2.

Company BR1 (retail) was changing its job evaluation method from a point factor scheme (Hay Guide Chart) to brief job descriptions plus market pricing at the time of the case study (2000). Three main reasons for this were pointed out by Company BR1. Firstly, point factor job evaluation encourages job promotions but it is less likely to encourage employees to increase their performance or contribution in their current jobs. This is because pay levels are strongly related to job content, and there are small pay differences for individual performance or contribution among employees with the same or similar jobs. This is perceived to have a negative effect on the business success of Company BR1.

Secondly, point factor job evaluation encourages vertical promotion but not horizontal promotion or horizontal career movement. Pay levels are strongly related to job content, and there are small pay differences for individual performance or contribution. Therefore, employees tend to focus on increasing job size in order to increase pay levels. Furthermore, the Hay Guide Chart that Company BR1 used includes budget size and number of direct reports as measurements of job size. Employees must emphasise vertical promotion in order to be promoted under the point factor scheme. This is not compatible with Company BR1's strategies in some respect.

The first is not compatible with the diversification strategy. Company BR1 is very keen to invest in other businesses within and outside the retail business. Regarding the retail business, company BR1 now places emphasis on the non-food business. The target of Company BR1 is to get to the number 1 position not only in the food business but also in the non-food business. The main reason for this positive investment in the non-food business is that profit margins in the non-food business are larger than those in the food business. Furthermore, if Company BR1 provides many types of goods, customers' satisfaction should increase. For example, if customers think that they can buy many products they need in the stores of Company BR1, they should visit those stores more often. The result is increasing turnover and profit. Company BR1 is also keen to invest in new business areas outside the retail business. Company BR1 thinks that customers have trust in Company BR1's brand, and therefore it is easy for Company BR1 to enter other business areas. Company BR1 thinks that it should use this good market position to expand the business and increase profits.

As described, Company BR1 is very keen to diversify. Company BR 1 has an internal deployment policy rather than recruiting from outside. This is because it has large amounts of information about existing employees such as areas of skills and knowledge that they hold, their attitude and behaviour, and their strengths and weaknesses. In contrast, it is difficult to gather the same amounts of information for workers outside Company BR1. Therefore, assessment of existing employees about whether they suit new jobs in the various new businesses is easier and more reliable than assessment of workers outside Company BR1. Therefore, development of employees across functions and not just within one function as a development policy is suited to the internal deployment policy. Thus, point factor job evaluation that encourages promotions within one faction is not suited to these policies.

Moreover, Company BR1 has a policy to prevent redundancy as much as possible. For example, a head office review of individual jobs revealed that Company BR1 has many job duplications in many departments or sections. However, Company BR1 did not execute redundancies. Instead, it created a resource pool into which employees working in the duplicated jobs are pooled. All employees in the resource pool can be employed in project works. Team members transfer between jobs or roles within the project team. Furthermore, employees also work across the project teams. They expand their experience and skills through a variety of project work. These experiences encourage these employees to transfer to new businesses as permanent deployment.

The second strategy, not compatible with point factor job evaluation, is that of flattening the organisational structure. A flat organisational structure is required to achieve quick decision making and reduce unnecessary personnel costs.

Company BR1 changed its promotion and development system for these reasons. In the past, promotion within one function was dominant in Company BR1 as in many other UK firms. However, it changed towards increasing promotions across functions, including both vertical and horizontal promotions. Now Company BR1 is positive about internal deployment as described above. Company BR1 considers that both management and employees gain benefits from these policies. Management benefits from employees who acquired a wider scope of skills, knowledge and experience, and contribute to business success using these. Employees also benefit from the wider scope of knowledge, skills and experience that can be rewarded in the long term.

The third reason for change of job evaluation method is increasing flexibility and adaptability for the labour market, and use of pay costs more effectively. In individual pay determination, Company BR1 participates in several market salary surveys and uses market salary data to adjust individual pay levels for market pay, but market pay is often divergent from pay levels based on the point factor job evaluation. Line managers had difficulties in deciding their members' pay levels, since information provided to line managers to make such decisions was divergent (between information from market pay and from internal relativity based on the point factor job evaluation). As a result, they are unlikely to refer to pay levels identified by the point factor job evaluation. This is because line managers must follow market pay rather than pay levels determined by internal relativity in order to retain talented employees whose market value is high. It is essential for their retention. In contrast, line managers do not have to pay higher pay levels to employees whose market pay is lower than internal relative pay levels. As a result, the usefulness of pay levels determined by point factor job evaluation is reduced, although pay determination based on point factor job evaluation takes a long time.

Company BR1 perceived these problems in the use of point factor job evaluation, and accordingly changed this job evaluation method to a non-analytical job evaluation scheme.

Company BT1 (telecom) changed its job evaluation method from the point factor scheme (Hay Guide Chart) to one based on brief job descriptions plus market pricing more than 10 years ago. The most important reason for this change pointed out by Company BT1 was to increase flexibility and adaptability of pay determination to a rapidly changing business situation (Company BT1 also pointed out other reasons, the same as Company BR1, such as increasing flexibility and adaptability for individual performance and labour market situation). The telecom business may be the most notable industry that has been experiencing quick and radical change among many industrial sectors. The main reason for this quick change of business is the rapid progress of technology.

Progress of telecom technology in the last ten years is tremendous. For example, internet usage such as email and websites, and the use of mobile phones was at a primitive stage then, but most people now use the internet and mobile phone on a daily

basis. Furthermore, the internet and mobile phones are now integrated. This rapid technological progress in the telecom business strongly influenced the business of Company BT1. About ten years ago the dominant mobile phone technology was first generation technology (analogue communication). This was replaced by second generation technology (digital communication), and now third generation technology (multi-media communication) is starting. In the quick changing technology, business requirements and employee profiles have also been changing rapidly. In fact, Company BT1 made redundancies at the same time as it continuously recruits new employees to meet new business requirements. Furthermore, the rapid changing technology and business environment encourage Company BT1's organisational restructuring, including a large number of acquisitions and alliances. According to the organisational restructuring, employees often transfer on a global scale. Pay determination must be very flexible in order to adapt to such rapidly changing employee profiles and frequent transfers.

Business requirements in Company BT1 are quickly changing. Jobs are reviewed every 6 to 12 months, as many new jobs are generated in the rapidly changing business environment. The time consuming nature of the point factor scheme is not compatible with the rapidly changing business environment. Even though Company BT1 set its pay structure according to the point factor scheme, the pay structure rapidly became obsolete. Company BT1 needs to change its job evaluation method to one that can adapt to the quick changing job and employee profiles.

Reasons for the change in the job evaluation method from the point factor scheme to a non-analytical job evaluation plus market pricing method among the case firms are summarised below. Firstly, as quick changing business situations requires flexibility and adaptability of jobs, the maintenance of pay structures based on job evaluation with complicated procedures is not compatible. As many new jobs are generated in the rapidly changing business situation. Even though they set their pay structure to the point factor schemes, pay structures quickly become obsolete.

Secondly, the point factor scheme is not flexible enough to deal with the labour market situation. This differs between job families or job areas. Since the point factor scheme focuses more on internal relativity than external relativity, the flexibility to deal with various types of external labour markets is reduced.

Thirdly, point factor job evaluation encourages vertical promotion, not horizontal career movement. For instance, the Hay Guide Chart uses budget size and number of subordinates to measure levels of accountability. The case firms have now flattened their organisational structure. Vertical promotion opportunities have become smaller. The case firms place more emphasis on horizontal career movement than vertical promotion. The point factor scheme is not suited to this situation.

Fourthly, even though jobs are similar, contribution levels are differentiated by individual. In particular, among senior employees, the contribution level is very different among employees with similar jobs. As the point factor scheme emphasises job content, it can reduce the adaptability of pay related to contribution.

Chapter 2 mentioned that an equal pay policy is more likely to be established by analytical job evaluation schemes than non-analytical job evaluation. How the case firms deal with the establishment of equal pay policy is the question. According to the case firms, an equal pay policy is established through internal and external comparison. In the internal comparison, equal pay policy is mainly examined using two methods: the comparison of pay levels between male dominated jobs and female dominated jobs and the comparison of pay levels between male and female employees with similar jobs. In the external comparison, the case firms gather many types of pay data and compare their pay levels with market pay rates. If the case firms offer market competitive pay for every job, they consider their equal pay policy to be established. This is because market pay indicates the value of the person shown as the value of the assigned job as determined by the market. According to the case firms, a judgment based on the market rate is objective and not biased by gender or any other type of discrimination. The research did not capture the extent to which equal pay is really established in the case firms. This is because equal pay often equates gender equity in the UK and this research excludes gender issues from the research subjects (as justified in chapters 2, 3 and 5). Therefore, situation of equal pay is not deeply analysed in this thesis as mentioned in chapter 2.

(2) Pay structure

Pay structure is included in the job factor in the same way as in chapter 2, because all

case firms operate a job grade structure. This popular pay structure in the UK differs from the traditional Japanese pay structure of *chingin hyou* (pay table). Many Japanese case firms changed their pay structure towards the 'box type' pay structure which is popular in the UK. The majority of the UK case firms also changed their pay structure. The current pay structures in the UK case firms are summarised in table 7-4.

Table 7-4: Pay structure in case firms

Case firm	Pay structure
Company BT1	Pay ranges are loosely grouped in five bands according to report levels. Individual pay levels are determined based on market pay rates for jobs. The pay structure changed from a traditional pay grade structure alongside a change in the job evaluation method. The job family pay structure has been implemented.
Company BT2	Formally no pay band system. Individual pay levels are determined based on market pay rates for jobs. The pay structure changed from a traditional pay grade structure alongside a change in the job evaluation method. The job family pay structure has been informally ¹ implemented as a reference of the HR department.
Company BF1	Pay ranges are loosely grouped into five bands according to report levels. Individual pay levels are determined based on market pay rates for jobs. The job family pay structure has been implemented.
Company BF2	Formally no pay band system. Individual pay levels are determined based on market pay rates for jobs. The pay structure changed from a traditional pay grade structure alongside a change in the job evaluation method. The job family pay structure has been informally ¹ implemented as a reference of the HR department.
Company BF3	Pay ranges are broadly grouped into six bands according to job size which is indicated by points determined through a point factor scheme.
Company BR1	Planned to change by 2002 ¹ so that pay ranges are loosely grouped into five bands according to report levels. Individual pay levels are mainly determined based on the market pay rates for jobs.
Company BC1	Pay ranges are loosely grouped into six bands according to report levels. Individual pay levels are mainly determined based on market pay rate for jobs. The pay structure changed from a traditional pay structure along with the change in the job evaluation method. The job family pay structure has been implemented.
Company BO1	Pay ranges are graded in 17 grades according to job size indicated by points

determined through a point factor scheme.

¹'Informally' means that job family pay structure is used only for reference of HR function and it is not communicated to employees as indicated in the text.

²The research for Company BR1 was conducted in 2000.

Features of the pay structure in the case firms can be summarised as follows. Firstly, five case firms (Company BT1, Company BF1, Company BF3, Company BR1 and Company BC1) have a small number of pay bands with wide pay ranges. These pay bands are broadly banded, whilst at the same time, pay bands are loosely banded in four of the case firms (Company BT1, Company BF1, Company BR1 and Company BC1).

The pay range of each pay band is indicated by lower, median and upper quartiles of pay levels, not by minimum, mid or maximum pay levels. The main purpose of this type of pay band in these firms is to capture the approximate pay levels of each employee level, not to control pay levels within the pay bands. However, HR in these firms wants to capture approximate pay levels for each employee level (or reporting level). However, individual pay levels among employees at the same levels are very different under the loose banding pay structure. For example, there are employees whose annual pay levels exceeded upper quartile pay levels in two higher pay bands in these case firms. Moreover, pay levels are very different between job families. For example, according to the case firms, differences in pay levels between employees at the same employee level between the finance and HR functions are often more than double. In this situation, establishing approximate pay levels for each employee level becomes difficult. The introduction of a job family pay structure can mitigate the problem. At least it becomes easier to establish the pay levels for each employee level within one job family. Furthermore, a job family pay structure can clarify to what extent pay levels differ among employees at the same employee level between job families. This is also of benefit to HR because it establishes how pay levels differ between job families.

Secondly, two of the case firms (Company BT2 and Company BF1) abolished pay bands corresponding to jobs. They are extreme or more progressive cases of broadbanding or loosebanding pay structure. However, this also makes pay administration difficult. The solution here is also the introduction of a job family pay structure, whilst their job family pay structure would only be used as reference for the HR function and would not be communicated to employees as the formal structure. Company BT2 was considering the implementation of a formal job family pay structure

at the time of the research.

Three case firms recently changed or are changing their pay structure to broad/loose banding or abolished pay bands altogether. The numbers of pay grades/bands before and after the change are compared in table 7-5.

Table 7-5: Recent change in pay structures

Case firm	Year of change	Change in pay structure
Company BF2	1996--1997	24 grades → Abolition of pay bands
Company BR1	2002	22 grades → 5 bands
Company BC1	2000	16 grades → 6 bands

The reasons for the change in pay band structure are similar to the reasons for changing job evaluation methods. The first is to increase flexibility and adaptability in the labour market. The labour market situation differs between job families or job areas. Pay bands with small numbers and wide ranges can increase the adaptability of pay levels for various types of labour market with different market rates.

The second is the increasing adaptability for levels of individual contribution. Even though jobs are similar, contribution levels differ among employees with similar jobs, especially at senior levels. Pay bands with small numbers and wide ranges can also increase the adaptability of pay to individual contribution levels.

The third is the facilitation of horizontal career development. Pay band structures with large numbers and narrow pay ranges tend to facilitate vertical promotion. As organisational structures have been flattened, vertical promotion opportunities have been decreasing. A broadbanding pay structure is considered as the pay structure associated with career development that includes horizontal rotation as well as vertical promotion.

Fourthly, the broadbanding pay structure is suitable for international deployment. If a pay band is narrowly designed, international deployment is often accompanied by a change of pay band, since the number and range of pay bands differs among group firms on the global scale. However, if a pay band in the UK parent firm is broadly banded, international deployment is not often accompanied by a change of pay band. This makes

administration of international deployment smoother.

For example, Company BR1 (retail) introduced a broadly and loosely banded pay structure. One of the reasons for this is international deployment. Company BR1 is keen on overseas investment, especially in continental European countries and Asian countries, and many employees recruited in the head office in the UK are deployed in other countries. If the pay band in the UK is narrowly banded, international deployment is often accompanied by a change in pay band. For example, if an employee in pay band 20 of a pay structure with 25 bands transfers to an overseas subsidiary in the Czech Republic where the pay band number is 17, the subsidiary of Company BR1 in the Czech Republic must calculate a new job size according to his/her new job in the subsidiary from scratch and decide on a pay grade corresponding to the new job size in the subsidiary under a pay structure with 17 bands. On the other hand, for example, if Company BR1 decides on a global transfer policy concerning pay bands, when employees on pay band 5 within a 5 band structure in the UK transfer to overseas subsidiaries, their new pay bands are slotted into the highest pay band, or highest two or three bands (when the number of pay bands is large) within the pay bands of the overseas subsidiaries. This makes easier for the subsidiary to decide in which pay bands the expatriates are slotted. Furthermore, changes of pay band may make employees uneasy. They may feel that demotion accompanies a change of pay band. No change of pay band realised by broad banding is a better solution for employees' feelings. For these reasons, a change in pay structure towards a broadly and loosely banded pay structure makes international deployment easier.

Specific examples of how and why pay structures changed is now described using the cases of Company BF2 (food and drink) and Company BC1 (chemical and pharmaceutical).

Company BF2 was established in 1997 by the merger of two UK food and drink firms. One of the former firms changed its pay structure in 1996 to a broader and looser scheme. Before the change, the pay structure was based on point factor job evaluation (Hay Guide Chart) and there were 24 pay bands. The firm thought this type of pay structure was problematic for several reasons. Firstly, as the number of pay bands was too large, there were, in reality, few recognizable differences in job content between each job grade (pay band equated to job grade despite no formal definition), in

particular at senior levels requiring high levels of skills and knowledge. This was because job contents for these jobs was less likely to be defined, and job content was more likely to be changed by job incumbents despite the fact that jobs are the bases of pay levels. The firm regarded this as being highly problematic.

Secondly, narrow pay ranges decrease flexibility and adaptability of pay for individual performance or contribution. Even though job contents according to a formal job description are similar, actual job contents are often changed by the job incumbent, in particular by senior level employees or knowledge-based employees as discussed above. Line managers change job descriptions, if job contents change. However, it is impossible to change job descriptions in detail to adjust to each occasion. At the same time, the firm, if necessary, must pay high pay levels in order to retain and motivate high contributors. But narrow pay ranges hindered rewards to high contributing individuals. As a result, line managers often ignored pay ranges and set pay levels beyond the pay ranges. Alternatively, job grades were promoted to increase pay levels, although actual job contents had little recognisable differences. In this situation, the pay structure did not function well. A change in pay structure to a smaller number and wider pay range is a better solution.

Thirdly, narrow pay ranges decrease flexibility and adaptability in the labour market. Pay levels are differentiated according to job families: for example there has been a recent shortage of marketing managers with a specialty in the food and drink business, therefore a firm must offer pay levels beyond pay ranges for recruiting and retaining such staff. In contrast, the firm does not have pay levels higher than market pay levels for employees whose market pay is lower than their pay ranges. A large number of pay bands with a narrow pay range decreases the efficiency of personnel costs. Broadly and loosely banded pay structures are a better solution.

Fourthly, pay structures with a large number and narrow pay range are not suitable for career progression. The firm now placed more emphasis on employee development than in the past. In the past, the firm diversified into unrelated areas, and often changed its business areas by frequent investment and divestment. At the time, management tended to be of the portfolio type. Investments and divestments were decided upon mainly according to the financial results of each business unit. Under portfolio management, the firm did not emphasise employee development, since the main stance of HRM was

'buying in human resources' from outside each time that the firm needed to. However, in the 1990s, the firm changed its strategy to focusing on its core business of food and drink. This organisation strategy changed the HRM strategy towards more emphasis on employee development. Internal promotion and career development became more important to the firm. One of the specific changes for this direction was the change of its job evaluation methods from the point factor scheme (Hay Guide Chart) towards a skills and competency-based scheme. Generic competencies were applied across functions, functional competencies and role-related competencies (which include skills and knowledge needed for each function and role) were introduced, and these competencies became the basis for pay bands. Furthermore, development aspects were emphasised more in performance management. Competencies were used as specific criteria to assess development aspects. Line managers also assessed career opportunities for each employee in the performance and development review, and individually discussed action plans with their employees in order to realise their career opportunities. At the same time, the pay structure was also changed to a broadly and loosely banded structure. This new pay structure suited career progression. There are two main reasons for this suitability. One is that a broadly and loosely banded pay structure can be used for both vertical promotion and horizontal movement. The other is that increased skills, knowledge and experience can be rewarded, even though there are no large differences in job content.

For these reasons, one of the former firms of Company BF2 changed its pay structure to a broadly and loosely banded structure. Company BF2 was established by the merger of two UK food and drink firms. The other former firm had 22 pay bands created on the basis of the point factor job evaluation scheme (Hay Guide Chart). After the merger, Company BF2 adopted a broadly and loosely banded pay structure based on skills and competency-based job evaluation described above. This is because a broadly and loosely banded pay structure with skills and competency-based job evaluation is suited to the new firm (Company BF2) in terms of making recognisable differences between pay bands and increasing flexibility and adaptability to the labour market situation and individual contributions. In addition, the other former firm also diversified into many areas, including unrelated areas, in the past. However it has also recently focused on its core business of food and drink. Furthermore, after its establishment, Company BF2 focused on narrower business areas such as alcoholic drinks and divested its food business. In the area of HRM, Company BF2 increasingly emphasised employee

development. Therefore, the broadly and loosely banded pay structure based on skills and competency-based job evaluation that can align with development and career progression is a suitable pay structure.

After the establishment of Company BF2, the pay structure has followed its direction as broadly and loosely banded. That is, Company BF1 abolished pay ranges corresponding to jobs. Company BF2 sets six employee levels according to reporting levels, and these six employee levels are linked to reward elements such as coverage and level for cash based profit sharing scheme, coverage and level for share options, coverage and level for employee benefits such as company car, pension and insurance. However these six employee levels do not have corresponding pay bands.

Company BC1 was formed in 1999 by the merger of two chemical and pharmaceutical firms -- one UK and one Swedish. After the merger, it sold the chemical business and now concentrates on the pharmaceutical side. Before the merger, the former UK firm had 16 pay bands based on the point factor job evaluation (Hay Guide Chart), and the former Swedish firm had 9 pay bands. After the merger, Company BC1 compared the pay structures of the two former firms and studied what type of pay structure would be desirable for the new firm. As a result, Company BC1 decided to create a pay structure that has a small number of pay bands with wide pay ranges. There are mainly two reasons for the decision. One is that a broadbanding pay structure increases flexibility for individual contributions. In Company BC1, as a research based pharmaceutical firm, the development of a new drug is crucial for its business success, therefore, rewards for researchers that develop new drugs are important for their business success. Contribution levels by individual researchers are largely different even though their formal job descriptions are similar. Furthermore, job contents cannot be precisely determined for the researchers. Job contents are largely differentiated by individuals' skills and knowledge. It is practically impossible to create job descriptions that can adapt to each employee's job contents for every occasion. In this situation, a pay structure is needed that has high flexibility and adaptability for individual contributions. Nonetheless, if pay bands are narrowly banded, it is difficult to adapt contributions for each employee, and pay levels tend to be attached to job contents that do not very much reflect the actual individual job contents. Company BC1 decided to create a broadly and loosely banded pay structure and set the number of pay bands to 5.

The other reason is to increase flexibility and adaptability to the labour market. In Company BC1, business success largely depends on the contribution of individuals such as researchers and medical representatives, and talented employees in these areas tend to have a high market value. In other words, recruitment and retention of these employees are key issues for business success. The provision of market competitive pay is necessary for the recruitment and retention of these employees. Moreover, as the labour market situation often changes, Company BC1 needs to continuously offer market competitive pay through adjustment for market pay. However, if pay bands are narrowly banded, the ability for adjustment for market pay decreases. Hence, the pay structure should be broadly and loosely banded in order to adjust constantly to the labour market situation.

Another change of pay structure is the introduction of job families as indicated in an earlier part of this 'pay structure' section. Three firms (Company BT1, Company BF1 and Company BC1) have formally implemented a job family pay structure and two firms (Company BT2 and Company BF1) have informally implemented a job family pay structure. The reasons for this are as follows. The first is to align pay structure with the career aspirations of employees. The UK workers tend to have career aspirations within one functional area. A job family pay structure aligns the pay structure with career development within one function. Line managers can easily explain pay levels of employees in relation to their career development. The second is making a close link with the market pay rate in each job family. In these firms, pay levels are based on market pay rates, and market pay rates are differentiated by job family. The third is making pay administration easy. A change in pay structure to a broadly and loosely banded pay structure makes the internal comparison of pay difficult, as discussed in earlier. The introduction of a job family pay structure is the solution. Another reason provided is that market salary survey data is organised based on job families and therefore implementation of a job family pay structure is easy where market salary survey data is used.

For example, Company BT1 (telecom) has implemented a job family pay structure. There are seven main job families in this pay structure, including engineering, research and development, HR, finance, marketing and sales, plus several small job families. The most important reason for the introduction of such a job family pay structure was to align the pay structure with employee career aspirations. The reasons obtained from

Company BT1 are as follows. In the UK, employees hardly change their job areas, the main reason for this being that employees are required to have specialist knowledge and skills for their recruitment. Therefore, it is difficult to change job areas in mid career. If job areas change, they inevitably accompany a pay decrease. Hence, employees rarely transfer to other job categories and they do not want to do so. Setting a job family pay structure makes for a clearer pay progression along with individual career progression. That is, individuals can easily see how their pay will increase in Company BT1. A job family pay structure also makes decisions regarding pay review by line managers easier. If line managers explain reasons for a pay review, the job family pay structure makes the explanation easier.

The second reason is so that pay levels are linked to market pay rate. Base-pay levels are determined based on market rates, and market rates are largely differentiated between job families. For example, a finance director's market pay is about three times that of a HR director's market pay. It is inefficient that one pay structure includes such large differences between jobs at a similar organisational level. The use of a job family pay structure is a good solution.

The third reason is making pay administration easier under broadly and loosely banded pay. Company BT1's pay bands are broadly and loosely banded. The number of pay bands is five as Director, Executive, Senior Manager 2, Senior Manager 1, and Staff. Each pay band is set by lower quartile, median and upper quartile not by minimum, mid and maximum. There are many employees whose pay levels exceed the median pay levels of one higher pay band. Furthermore, there are employees whose pay levels exceed the median pay levels of two higher pay bands, although the number of such employees is not large. Company BT1 needs this broadly and loosely banded pay structure in order to recruit and retain talented employees through the increasing flexibility and adaptability of pay for labour market situation and individual contribution levels. However, this highly flexible and adaptable pay structure makes pay administration difficult, for example comparison of pay levels of employees with the same or similar organisational level as pointed out earlier. The solution is the introduction of a job family pay structure.

The fourth is making pay administration easier in use of market pay. Market salary survey data are formed based on job families. Therefore, setting a job family pay

structure makes pay reviews easy under the use of a market salary survey.

7.3.2 Market factor

The next consideration is the market factor (market rate for a job). All the case firms consider external market rates for jobs. They set the position concerned against the market pay rates for average pay levels. The positions concerned are largely divided into the market median and upper quartiles of market pay rates. Company BT2, Company BF1 and Company BC1 set the market median. Company BT1, Company BF2, Company BF3, Company BR1 and Company BO1 set pay at the upper quartile of market rates. However, these positions are rough guidelines and not strict rules within these case firms. Also, competitors in the labour market differ among these case firms. Some firms focus more on large MNCs in wider industrial categories, such as world consumer goods, and others focus more on their industrial sectors and UK domestic firms. Therefore, pay levels in the case firms which are setting the upper quartile level are not necessarily paying more than in those firms setting pay at the market median level.

In the past, all of the case firms gave higher priority to internal rather than external relativity. However, six case firms (Company BT1, Company BT2, Company BF1, Company BF2, Company BR1, Company BC1) shifted their priority from internal towards external relativity.

For example, one of the former firms in Company BC1 (chemical and pharmaceutical) gave higher priority to internal relativity. At the time, individual pay was determined mainly through internal relativity. A specific method used at the time was point factor job evaluation in order to decide the relative importance of an individual's job within the firm. This type of pay determination was suitable when the firm focused on internal relativity. However, after the establishment of Company BC1, it decided to abolish this type of individual pay determination. One of the main reasons is that emphasis on external relativity is more important for recruitment and retention of talented individuals than internal relativity. Even though Company BC1 established internal equity, if it failed to offer market competitive pay to talented individuals, it could not recruit and retain such individuals who had a high market value. On the other hand, Company BC1 does not have to use unnecessary pay costs for employees whose market pay is lower

than pay levels determined through internal relativity. Pay costs should be used more effectively in order to compete in a highly competitive market. Furthermore, market pay is different between job families, even among jobs determined as having a similar level of importance established through internal comparison. Moreover, the labour market situation changes often. For example, large scale mergers, which have often happened recently, can change the labour market situation. As another example, if large pharmaceutical firms increased their number of medical representatives on a large scale, the market situation in this job family changes. Pay determination through internal relativity cannot cope with these rapid changes in the labour market.

Furthermore, Company BC1 thinks that the establishment of internal equity between different job families does not have any significant meaning for the recruitment and retention of employees. This is because employees tend to compare their pay levels within their job families both internally and externally, and they are less likely to compare their pay levels with other job families. For example, marketing managers do not seriously compare their pay levels with financial managers. Therefore, even though Company BC1 incurs costs in establishing internal equity, gain from the cost is small. Instead, provision of competitive pay within one job family both internally and externally is more important. Market pay provides market competitive pay levels. Therefore, Company BC1 decided that placing more emphasis on external relativity is a desirable option.

All case firms use various methods to gather information about market pay. The main method is participating in market salary surveys. The case firms buy several available market salary surveys, including non-participants. Other methods such as checking job advertisements and salary surveys conducted at national/regional/industrial/occupational levels are also used. All of the case firms have market pay specialists in the HR to deal with market pay. One of their main jobs is to create the firms' own market pay data on global, European, national or regional levels using a mixture of various types of market pay data.

Firms focusing on external relativity changed their job evaluation method from a point factor scheme to a non-analytical job evaluation based on a brief job description. Decisions on individual pay levels through non-analytical job evaluation are as follows. Pay ranges are set at around $\pm 15\%$ to $\pm 20\%$ against market pay rates (median or upper

quartile), and individual pay levels are then decided within this range. If pay levels exceed 15% or 20% of the standard, base-pay is not increased. Instead, high contribution is compensated with variable pay such as a cash incentive and/or share options. This is the basic policy within the case firms. This guideline for the market pay range is not necessarily applied to all employees. If employees are recognised as valuable, the firms can exceed this guideline according to the judgment of the line managers, while approval of HR is often needed for the final decision. Operation of market driven pay determination will be described in section 7.5 (payment system in Company BT2) in detail. Further, how line managers determine individual pay rates based on market pay rates will be also discussed in section 7.4.3.

Reasons for focusing on external relativity and change of pay determination method are summarised below. The first is that pay levels should be adaptable to market pay rates in order to attract and retain valuable employees (not all employees). Secondly, as pay levels are largely different between job families, emphasis on internal relativity cannot cope with the pay difference between job families. Thirdly, market-driven pay can prevent unnecessary pay drift or pay related to years of service.

Regarding the third reason, when the case firms determined individual pay levels based mainly on internal relativity, pay levels increased annually, even though the job levels did not change and regardless of contribution levels or the market pay situation. As a result, pay increased with years of service, and finally many employees reached the maximum point within their pay ranges. In some cases pay levels were increased by 'job promotion', even though a change of job levels was not accompanied by substantive differences. Market-driven pay determination changed these situations. This is because where job content partially changes, if the change does not alter the market pay rate levels, the pay level does not change.

Company BF3 and Company BO1 consider internal relativity first. They also consider the market pay rate for jobs. Individual pay levels are compared with market pay rates and adjusted, and if the market pay rates are higher than the corresponding pay ranges to jobs, pay is increased beyond these ranges. Attraction and retention of valuable employees are more important than maintenance of pay structures in these firms.

The case firms that focus on external relativity also consider internal relativity. The

internal comparison is practiced through external comparison. Individual pay levels are compared as relative positions in relation to external market pay rates. If the relative positions are very different among employees, pay levels are adjusted in order to establish internal equity.

7.3.3 Person factor

Within the person factor, output performance and competency (input and process) are considered. Although this thesis divides the output (output performance) and input aspects (input and process such as competency) of the person factor, the distinction between these in the UK case firms as the element that constitutes pay or base-pay is not clear unlike in the Japanese case firms. There are two reasons for this lack of clarity in the UK case firms. The first is a characteristic of pay review practices where pay levels are determined by the comprehensive judgement of line managers in consideration of many factors, which will be discussed in section 7.4. Therefore, the influence of each factor for pay is not divided. This is the main reason for the lack of clarity. The second is a characteristic of performance review practices, which is one of the inputs for pay reviews. Although most UK case firms work out the assessment of output performance and competencies as a rating for each item, output performance and competencies are mixed in the overall rating. Therefore, in an overall rating, the distinction between output performance and competency is blurred. Thus, the mixture of output performance and competencies could be used to describe performance and pay review processes in the UK case firms. However, these firms tend to treat competency as a different aspect to output performance in assessment of person factor. Considering these practices, 'competency' should be discussed separately from 'output performance'. Yet, within discussion of 'output performance', wider concepts such as 'contribution' are included.

(1) Output performance

All of the case firms emphasise output performance in individual pay reviews. They all assess employee's results or achievements within the performance review⁹³, and the result of this review is one of the inputs into the pay review. According to the case firms

⁹³ All case firms operate performance management and they use the term 'performance review' as the appraisal function.

there are various reasons why the firms emphasise output performance or contribution in terms of pay. The first is to retain and motivate high contributors or highly valued employees. The second is to tell employees about the management judgment of their contribution. The third is to create a performance culture and end the entitlement culture. The fourth is the effective use of money. The fifth is increasing effectiveness of performance management. As a link with pay can generate an immediate effect on employees, establishing such a link increases the effectiveness of performance management.

How and why case firms emphasise output performance for pay determination are described using three case firms. The first example is Company BF2 (food and drink). Company BF2 was formed by a merger of two UK food and drink firms. Before the merger the former two firms had diversified, including into unrelated business areas, and often bought and sold business areas. However, both firms recently focused on their core business of food and drink. After the establishment of Company BF2, it has further concentrated on the alcoholic drink business in beer and spirits, and sold its food business. Company BF2 has the largest share in the spirits market on a worldwide scale. However, even the largest of firms has difficulty in growing its business and increasing revenue and profits. This is because the high-class spirits market in advanced countries, the main market of Company BF2, has already been saturated and it is difficult to increase the spirits market as a whole, although some spirits such as vodka have an increased market. In this situation, market competition among other spirit firms has been increasing, since sales and profit growth is mainly derived from taking customers' preference to its own brand of spirits from brands in other spirit firms. Performance culture is very important in this situation. However, generally an alcoholic drink firm is unlikely to have a performance culture because this business is relatively stable, as customers' loyalty to one particular type of spirit or particular type of brand does not change quickly, although it changes in the long term. Therefore, employees who enter the alcohol business tend to prefer stability rather than challenge, and the culture tends to be one of entitlement. Company BF2 thinks if the newly created Company BF2 has such a type of culture, it must change quickly, and create a performance culture. In particular, now is the critical time to create a performance culture, since two former firms with seemingly different cultures merged and created a new organisation. Once an entitlement culture is established, it is difficult to change.

Company BF2 has launched various policies in order to create or strengthen a performance culture under the headline of 'Company BF2's Way of Managing Business Performance'. For example, 'Consequence Management', which focuses on establishing performance expectations and responding to performance delivery through personal and organisational commitment, started in July 2000. 'Performance Targets', the setting and stretching of performance targets across the organization, was initiated by the CEO, function heads, business unit general and functional managers, and was launched in July 2000. 'Strategy to Execution' was planned and implemented by an executive team in each business unit. Six month pilot projects in each business unit were started by April 2000 supported by initial workshops and followed by project set-up. 'Key Performance Indicators' that measure the execution of strategy against agreed targets was launched by July 2000. In addition, these policies to increase business performance were linked to people management under the headline of 'Company BF2's Way of Building Talent'. Various policies were introduced under this headline such as 'People Performance Management', 'Benchmark for Development', 'Building Talent Workshops', '360 Degree Feedback', 'Coaching Capability Development' and 'People Development Review'. In the area of pay, People Performance Management plays a key role. It links various policies in 'Company BF2's Way of Managing Business Performance' and individual performance management, including performance and development reviews. Company BF2 thinks that people differentiate business, therefore, the commitment of employees to achieve business performance is critical for business success. Furthermore, a link with pay is necessary in order to achieve commitment of employees for business success.

There are other reasons for placing emphasis on output performance in Company BF2. Retention and motivation of high contributors or highly valued employees are necessary for business success. As the market of Company BF2 has been saturated, their business success is mainly derived from, the stable delivery of high quality products and services, the development of new high quality, customer oriented brands, and the development of good marketing and sales strategies. The contribution of individuals in these areas varies greatly between individuals. Therefore, the retention and motivation of high contributors, and not all employees, is very important. Telling employees about management judgement of their contribution is necessary to create a performance culture. Communication about an employees' contribution can also increase their contribution levels. This benefits both management and employees. Furthermore, the

effective use of money is necessary for business success under increasing market competition.

The second example is Company BT1 (telecom). Company BT1 also emphasises output performance for individual pay determination. One of the reasons is the creation of a performance culture in which only employees who contribute to Company BT1 are rewarded, and reward levels are clearly differentiated according to individual contribution through making clear links between individual contribution and pay. As Company BT1 has been rapidly and constantly growing along with the expansion of the mobile phone market, average pay increase rates were high and most employees were awarded high pay increases in the past. The link between individual output performance or contribution and pay was weak, although Company BT1 has a hard work culture. Company BT1 introduced a performance management system in 2000 in order to make a clear link between individual contribution and pay levels.

Another reason for the introduction of performance management is the establishment of a standardised procedure in the area of HRM. As Company BT1 was a small firm and had been growing rapidly, the level of standardisation was low. Although Company BT1 is now a globally operating firm, some aspects of the small firm still remain in many area, including HRM. However, Company BT1, as a large MNC, now needs more standardisation in HRM decisions.

For these reasons, Company BT1 introduced a performance management system in 2000. However, the new performance management system was not implemented uniformly across the organisation. According to corporate HR, around 30% of departments did not implement the performance management cycle. One of the reasons for this was resistance of line managers who had worked for Company BT1 for a long time. This is because those managers entered Company BT1 when it was small, and were familiar with a less a standardised style, or they entered Company BT1 because they liked the small venture type culture that hardly used standardised procedures. In fact, employee interviews (both line managers and non-line managers) found that generally they thought that performance review results and pay review results were not highly related in Company BT1 compared with their previous firms.

The third example is Company BF1 (food and drink). Company BF1 set a new aim of

double digit growth in both sales turnover and profits every year when a new CEO was appointed in 1999. There are two main reasons for setting this target. The first reason is the emergence of Company BF2 as an industrial giant in the spirits market, which changed the market situation. Although Company BF1 is the second largest spirit firm in the world market, Company BF2 has triple of the turnover to that of Company BF1. Company BF1 needs strong competitive power in order to compete with Company BF2. The double digit growth is a method to achieve such high competitive power. For example, high quality is needed in many areas such as research and development and marketing in order to achieve the double digit growth as well as cost reduction. Company BF1 expects to have higher competitive power through achievement of the double digit strategy.

The other reason is the prevention of a takeover by other firms. There are several large alcoholic drink firms operating globally, including Company BF1. Most of these large alcoholic drink firms are family owned with the exception of Company BF1 and Company BF2. Therefore, it is difficult to merge with other firms except with Company BF2. For Company BF1, merger with Company BF2 means acquisition by Company BF2 due to the large difference in their sizes. Accordingly, it could hardly be considered a merger with Company BF2. Hence, Company BF1 has difficulty in merging with other firms in order to increase its size. The new CEO thinks that the current scale of Company BF1 is likely to make it become the target of acquisitions, and a useful method to prevent this is increasing its market value. Increasing turnover and profits is necessary to increase market value.

Company BF1 set three HRM agenda in order to achieve the double digit strategy; 'right people right place', 'right reward' and 'implementation of HR best practices across the group firms'. The 'global reward framework' was implemented in order to achieve the 'right reward' policy. The main policy for the global reward framework was a direct link between individual contribution (including both output performance and competencies), organisational performance and pay. Concerning the direct link between individual contribution levels and pay levels, Company BF1 thought that the correlation between individual contribution and pay levels were generally weak. Pay increases across the organisation were the usual practice. As a result, many employees tended to consider that pay levels should increase according to years of service. This created an entitlement culture, not a performance culture. However, a performance culture is

essential to achieve double digit growth in turnover and profits. A performance culture in Company BF1 means that people put a high priority on achieving high organisational performance, and people believe that those who contribute to high organisational performance are necessarily rewarded. Company BF1 thought that the pay determination method had to change in order to achieve a performance culture.

Company BF1 set the policy for base-pay as 'salary increases based on merit only'. That is, a low rating would result in a zero pay increase. Furthermore, once Company BF1 sets the policy as salary increase based on merit only, objective and consistent measurement for employee merit is necessary (merit in Company BF1 is output performance and competencies). If Company BF1 fails to achieve objective and consistent measurement, employees do not believe that the policy 'salary increase based on merit only' and Company BF1 fails to achieve a performance culture. Hence, Company BF1 implemented a more standardised performance management system across the organisation in order to measure individual contributions more objectively and consistently. Although a performance management system had already been implemented in Company BF1, the operation of performance management differed between divisions and line managers. Some line managers were not set objectives through discussion with their members. Some line managers were simply not set objectives. Corporate HR sets guidelines for performance management such as output performance based on objectives set, while objectives are set through discussion and agreement between line managers and employees. In addition, various training was conducted for line managers to improve managers' skills in performance management and to use performance management in a consistent manner.

Concerning organisational performance, Company BF1 increased variable pay levels related to organisational performance in order to align employees' interests with organisational objectives, and to share organisational success among management and employees. Company BF1 set some new variable pay schemes, and set payment targets in the variable pay scheme, and conditions to determine levels of variable pay. Company BF1 tried to achieve its aim of double digit growth through a change in the payment system by creating a stronger link between individual contribution and organisational performance, and pay levels.

The problem for Company BF1 lay in decreasing base-pay levels from the upper

quartile towards the market median as an average. Company BF1 decreased an average position to market pay rates instead of increasing variable pay levels related to organisational performance. This caused suspicion and dissatisfaction among the employees. HR had predicted that this would happen. Because variable pay was unconsolidated to base-pay increase, variable pay has more at risk. Therefore, Company BF1 thought that pay determination must have higher levels of consistency, objectivity and fairness in order to prevent dissatisfaction among employees. The change to performance management as discussed above is one method to achieve this. Company BF1 also introduced competencies and a job family pay structure and changes to the pay band structure to be broadly and loosely banded. All of these policies have the purpose of increasing consistency, objectivity and fairness. 'Audit on Reward Change' revealed employees' dissatisfaction for decreasing base-pay levels and employees suspected that the new reward policy would increase variable pay, as revealed by a statement made in an internal company document; "big change, feel very upset about pay freeze, really believe targets are unattainable, even managers think this, predict a mass exit when bonuses are not announced, slow growth industry, people want to come the spirit industry for a quieter work like". 'Audit on Reward Change' also revealed that performance management was not implemented across the organisation, and many managers ignored the competency assessment. Reward change in Company BF1 has just started, and it has many problems in operation so far.

Although the case firms emphasise 'pay for performance' or 'pay for contribution', most employees receive an identical pay increase in all of the case firms. The majority of employees in the case firms take 3 - 4 % or 4 - 6%⁹⁴ pay increases. For example, base-pay increases in Company BF2 (food and drink) in 2000 as follows. Company BF2 categorised employees according to performance level (the levels are linked to ratings in performance review, although not strictly) as top performers, strong or moderate performers, middle performers and low performers. Pay increase rates for top performers were 7-10%, 5-7% for strong or moderate performers, 3-4.5% for middle performers, and 0-3% for low performers. The average pay increase rate was 4.5%. 10 to 15% of employees were categorised as top performers, 5-10% as low performers and the other 80% of employees were strong or moderate, and middle performers.

All the firms including Company BF2 have a strong central tendency towards pay

⁹⁴ Average pay increase rate differs by case firm and by year (2000 and 2001).

increase rates. Only a very small minority of employees have a pay increase of more than 10%. None of the UK case firms operate forced distribution. Therefore, why the case firms do not make large distinctions between the majorities of their employees is the question. HR interviewees admitted that there is a small difference and claimed that pay increase rates should be differentiated more by contribution or value of the individual. Internal documents indicate that they planned larger pay dispersal by contribution or the value of individuals. But in reality, the case firms do not make this distinction for many of their employees. The reason obtained from the HR interviewees is that many line managers are not good at performance reviews. A large difference due to poor judgment can cause dissatisfaction amongst employees.

There are some assumptions regarding reasons why the case firms do not make a large pay distinction for many employees. Firstly, the purpose of the performance review includes judgment on dismissal and selection of a redundancy pool, as will be discussed in section 7.4.5. This practice sends a message about contribution levels and creates a performance culture in the same way as IPRP. Secondly, as a very small minority of employees gets high pay increases such as 20% or 30%, the case firms benefit from retention and motivation for a small number of valuable employees. Thirdly, pay levels of senior managers are more differentiated than those of other employees through various financial rewards such as base-pay, cash-based profit-sharing and share options. As 'pay for contribution' is particularly emphasised for senior employees in the case firms, the policy is achieved, even though many employees receive an almost identical pay increase rate.

Another interpretation is that the HR plans to make large pay distinctions, but fails to do so because their power is low. UK researchers argue that there is a weak position and minor influence of HR in strategic decisions (Legge 1995, Purcell 1988, 1995). A survey revealed that HR was unlikely to be involved in strategic decisions and the UK owned-firms were less likely to have an HR director on the main board than large overseas-owned firms in the UK (Marginson et al. 1993). The weak position of the HR may be one of the reasons why the case firms do not make large pay distinctions for many of their employees.

(2) Competency

The other person factor included in the individual pay review is competency. Competencies are formally included in performance reviews in seven case firms (information on competency was not gathered from Company BO1). However, the extent to which line managers really assess competency in performance reviews and whether competency assessment is considered within pay reviews are controversial. Before the discussion of competency pay in the case firms, types of competency profile and the purposes of these shall be considered. The types of competency profiles used in the case firms are summarised in table 7-6.

Table 7-6: Type of competency profiles used in case firms

Case firm	Types of competency profiles
Company BT1	- Generic competency profiles that cover all employees and are divided by employee level. - Role related competency profiles.
Company BT2	- Generic competency profiles that cover all employees.
Company BF1	- Generic competency profiles that cover all employees and are divided by employee level. - Functional competency profiles divided by job family.
Company BF2	- Generic competency profiles that cover all employees and are divided by employee level. - Functional competency profiles divided by job family.
Company BF3	- Generic competency profiles that cover all employees.
Company BR1	- Generic competency profiles that cover all employees and are divided by employee level.
Company BC1	- Generic competency profiles that cover all employees. - Functional competency profiles divided by job family.
Company BO1	- Information regarding competency profiles was not gathered.

The competency profiles used in the case firms can be divided into two types; generic competencies and functional or role-related competencies. The former focuses on behavioural indicators whilst the latter includes skills and knowledge required by functions or roles.

For example, Company BT1 (telecom) applies generic competencies to all employees

across functions. There are two types of generic competencies: one is general competencies applied to all employees and the other is divided by employee levels. There are three types of competency profiles of the latter type: staff, senior manager and executive. General competencies for all employees include ten areas (competency headline) such as drive for results, communication, customer focus and judgement. Behavioural indicators are exemplified under each competency headline. Competency profiles divided by employee level are similar to competency profiles applied to all employees in terms of competency headlines, but the behavioural indicators under each competency headline differs between employee levels. Furthermore, two types of behavioural indicators -- favorable indicators and unfavorable indicators -- are described in competency profiles divided by employee levels.

Company BT1 has another type of competency profile related to its corporate value named the 'Way We Work Value' that is applied on a world-wide scale (generic competencies described above are applied only to UK-based firms in Company BT1 group).

The third type of competency profile is role-related competency. There are two steps for the development of role-related competency profiles. The first step is the development of functional competencies for each job family. The functional competencies include not only behavioural indicators but also skills and knowledge required for each job family. The second step is that line managers add the necessary skills and knowledge not covered by the functional competencies.

The three types of competencies -- generic competencies (applied to all employees and divided by employee levels), competencies related to the 'Way We Work Value' and role-related competencies -- are assessed in performance and development reviews. In generic competencies, competency profiles divided by employee levels are used as assessment criteria, because they contain more detailed behavioural indicators, including favorable and unfavorable behaviours. Although competencies are assessed in performance and development reviews against formal guidelines set by corporate HR, not all line managers assess competencies based on these three types of competency profiles. Corporate HR thinks that one of the reasons is that there are too many competency profiles and behavioural indicators. As a result, line managers may be confused. At the time of the research (2000 to 2002), Company BT1 was simplifying

the contents of the competency profiles.

There are various reasons for the introduction of competency profiles within performance reviews. The most common purpose among the case firms is to ensure long term success of the firms. If the case firms only assess output performance or results and ignore how results are achieved, employees may only concentrate on short term results and ignore important issues which would achieve long term success. Competencies provide criteria on desirable behaviour in order to achieve the results. The second reason is to assess the aspects that are difficult to assess quantitatively. The measurement of output performance tends to focus on quantitative aspects, but not all performance can be assessed by quantitative measurement. Competency profiles provide criteria to assess softer aspects that are difficult to assess quantitatively.

The third reason is the strengthening of the development function of performance management. For instance, Company BT1 (telecom) has been growing rapidly in the mobile phone business. In the past, development was not focused upon in Company BT1. This is because rapid expansion in the business of this firm enabled the provision of job promotions and high pay levels for many employees that functioned to recruit and retain employees. However, the same speed of expansion cannot be expected anymore, since the mobile phone market in the UK is saturated. Company BT1 needs to provide another type of reward in order to recruit and retain talented individuals. This is because there are labour shortages in high-tech industries that share the same labour market. Although from 2001 the labour shortage was relaxed under so-called 'high-tech recession', Company BT1 thinks that the labour shortage of engineers and researchers with the skills and knowledge required by the business of Company BT1 is a basic trend. Contents development of multi-media communication is now urgently required. Furthermore, contents development and stable delivery of high quality multi-media communication will be increasingly important in the future. Recruitment and retention of the key employees are critical to business success. Moreover, Company BT1 has difficulty in recruitment and retention due to its location; its head office is located in Newbury, far from London. The location is not an attractive working place for a young and international population. In addition, there are many high-tech firms located in places nearer to London than Company BT1. For example, O2 is near Slough. In the circumstance, Company BT1 must provide other types of benefits in the situation where decreasing high promotion opportunities and provision of high pay levels for many

employees cannot be maintained anymore. The provision of development opportunities is one of them. Company BT1 introduced competency profiles as a concrete method of linking performance reviews and development.

Company BF1 and Company BF2 may be the most positive case firms in terms of their use of competencies in performance and pay reviews. Company BF1 (food and drink) introduced competency profiles in 2001. There are two main reasons for the introduction. One is the achievement of 'right people right position' as one of the new HR agenda that Company BF1 set to achieve its aim of 'double digit growth in both turnover and profits' as indicated in the 'output performance' section. Company BF1 started competency assessment for senior managers in 2001 (competencies are assessed through competency interviews) and plans to assess competencies for all employees within two years. Company BF1 tries to select the right people for the right positions through competency assessment (two senior managers resigned from Company BF1 as a result of the competency assessment). The other reason is to develop a common language that shares and understands the same meaning. As Company BF1 operates on a global scale, if employees use a different language (technical terms), Company BF1 cannot create consistency across the organisation; this in turn reduces organisational efficiency and effectiveness.

Types of competency profiles are divided into global competencies applied to all employees on a global scale and functional competencies developed for each job family (functional competencies are developed in each country). The global competencies consist of behavioural indicators, and functional competencies consist of skills and knowledge needed for each job family. The global competencies consist of eight competencies (competency headline) such as big picture thinking, commercial rigour and making things happen. While the competency head lines are applied to all employees globally, behavioural indicators are differentiated by employee levels. In the UK, behavioural indicators are divided into five categories.

Company BF1 is very keen on the use of competencies for performance and pay reviews. Competencies are assessed in the performance review and the assessment is related to overall ratings. In relation to overall ratings, competencies are weighted (1/2) the same as output performance (1/2). HR practitioners emphasise the use of competencies in performance and pay reviews. If an employee receives high ratings for

both output performance and competencies, they will receive a high pay increase. But if employees receive low ratings for both output performance and competencies, their pay may be frozen. Furthermore, if employees receive low ratings in both output performance and competencies twice consecutively, they may be sacked. However, competency appraisal did not work well for line managers at the time of the research (2001), according to employee opinions gathered by HR. However, according to HR practitioners, individual competency assessment through competency interviews had just started with senior managers, and all employees would be assessed for their competencies through competency interviews within two years, therefore, employees may understand competencies through their own competency assessment.

The introduction of competencies in Company BF2 is traced back to the introduction of competencies in one of the former firms in 1996 (Company BF2 was formed by the merger of two UK food and drink firms in 1997). The former firm introduced competencies and linked competencies with performance and pay reviews, when it changed its job evaluation methods (from point factor job evaluation towards skills and competency-based job evaluation) and pay structure (from narrowly and rigidly banded towards broadly and loosely banded pay structure) in order to increase alignment of pay progression with career development as discussed in the section on 'pay structure' (the reason for increasing development needs was also discussed in the 'pay structure' section). After the establishment of Company BF2, it decided to introduce a competency approach. Competencies are assessed in the performance review and the assessment is related to overall ratings. In relation to overall ratings, competencies are weighted (1/2) the same as output performance (1/2). HR practitioners in Company BF2 also emphasise the use of competencies for performance and pay reviews as do HR practitioners in Company BF1. The policy for pay reviews relating to competencies in Company BF2 is the same as that in Company BF2. If an employee receives high ratings for both output performance and competencies, they will receive a high pay increase. But if employees receive low ratings for both output performance and competencies, their pay may be frozen. Moreover, if employees receive low ratings in both output performance and competencies twice in succession, they may be sacked.

Company BF2 is also keen to use of 360 degree feedback for pay purposes. Assessment based on 360 degree feedback is utilised for performance reviews, and competencies are assessed in a questionnaire for the 360 degree feedback. Company BF2 thinks that

information from multiple resources is useful for the assessment of qualitative aspects such as competencies. Specific methods to gather information from the 360 degree feedback vary between divisions or line managers such as sending a feedback report from the 360 degree feedback to the employees, and setting up meetings with the subjects of the 360 degree feedback exercise to gather more precise information and better utilise the information from the 360 degree feedback exercise. The idea that persons providing the 360 degree feedback should be anonymous is a popular one (Borman 1997, Chivers and Darling 1999). However, Company BF2 thinks that the subject employees of the 360 degree feedback exercise can often recognise who are giving the feedbacks, even though those providing the feedback are anonymous. Therefore, anonymous sometimes has little meaning. In these cases, disclosure of those providing the feedback is sometimes more effective in the use of the 360 degree feedback exercise. However, whether disclosure is more effective or not depends on the situation within each workplace or on the relationship between employees. Therefore, each division or line manager has to decide how to gather the information from 360 degree feedback.

As noted, Company BF1 and Company BF2 are keen to use competencies for performance and pay reviews. They weight competencies and output performance as even in overall ratings. These firms have a similar policy for pay reviews. If employees receive high ratings for both output performance and competencies, they will receive a high pay increase. If employees receive low ratings in both output performance and competencies, their pay may be frozen. Furthermore, if employees receive low ratings in both output performance and competencies twice in succession, they may be sacked. Such strong emphasis on competencies is different from other case firms where there is more emphasis on output performance than competencies, and competencies are used as supplements in the assessment of individual contribution.

As described, most case firms have implemented competency profiles and assess competencies in performance reviews as part of a formal system, although the degree of emphasis for competencies differs between the case firms. However, assessment of the competencies which are included in the pay reviews is controversial. Among the seven firms operating competency profiles relating to performance review, HR interviewees in four firms (Company BT2, Company BF1, Company BF2 and Company BF3) answered that competencies are linked to pay. The reason for this answer is that competencies are

assessed within the performance review, and the results of this are one of the inputs in pay reviews. Therefore, line managers must consider competencies within pay reviews.

Two firms (Company BR1 and Company BC1) said no, since competencies are used only for development purposes within performance management. In the case of Company BC1, the main purpose of performance management is development and there is no rating system within the performance review. Pay review is a separate process from the performance review. Competency assessment is especially emphasised as a development tool in the performance review. Therefore, the HR practitioners considers that line managers would not input competency assessment into pay reviews. Company BR1 is the same, as it emphasises the development purpose of competency assessment. However, the competency assessment is included in the overall rating of the performance review and this rating is the most influential factor in pay reviews in Company BR1, according to the formal guidelines.

In Company BT1, opinions are varied among HR interviewees. One interviewee answered no, because competencies are only used for development purposes. One interviewee answered yes, because competencies are assessed within performance reviews, and the results of these are related to pay reviews. Even in HR interviewees, whether or not the competency assessment is related to pay reviews is controversial. Whether the competency assessment is actually considered in the pay review of line managers is more problematic. In addition, whether competencies are really assessed within performance reviews is also problematic. 'Audit on Reward Change' in Company BF1 revealed that all line managers do not necessarily assess competencies within the performance review despite its formal policy set by corporate HR.

The author asked five line managers in Company BT1 and Company BT2 about competency assessment; 'do you assess competency in performance reviews, and do you consider competencies in pay reviews?' Answers were divergent among the managers. Three managers answered 'yes' for performance reviews, and two managers answered 'yes' for pay reviews. One line manager in Company BT2 answered 'no' for competency assessment in performance reviews, but he said that he assesses competencies within risk assessment⁹⁵, and the result of this is reflected in the pay

⁹⁵ Company BT2 implements 'risk assessment' for retention purposes. 'Risk Assessment' assesses value and possibility of turnover of individuals. If individuals are assessed as high

review. Therefore, competencies are indirectly related to pay reviews.

As described above, whether or not competencies are really assessed within performance management and whether competency assessment is really related to pay reviews is not clear. Furthermore, the number of participants who were asked this question was very small -- just five interviewees (the author did not ask all interviewees due to time constraints). Therefore, the thesis cannot conclude on the situation of competency assessment within the case firms based on the answers given. In addition, the author did not interview line managers in Company BF2 which would be one of the most positive case firms for competencies within performance and pay reviews as discussed. Company BF2 has longer experience of using competencies than Company BF1, which is also very positive for competencies, that introduced competencies in 2001 (at the time of the case study). The situation in Company BF1 could be different to that in other firms.

The case firms generally emphasise competency less than output performance, except in Company BF1 and Company BF2, which put the same importance on output performance and competency in overall ratings in performance reviews. Output is more important for most case study firms in performance and pay reviews. Competency tends to be used as a supplementary element. Line manager interviewees also emphasise output performance and market pay rates as important factors for their pay reviews. This attitude is consistent with the formal pay policies within the case firms.

Competency may be the factor within pay reviews that covers the areas not covered by other factors such as output performance and value of the job. Even though there are no explicit lists of competency profiles, line managers may consider factors expressed as terminology of competencies. As will be described within the pay review section (section 7.4), line managers consider the value brought by individuals in order to retain their staff through their pay review. In this sense, discussion on whether or not competency pay is used in a strict sense may have little significant meaning. This is because individual pay reviews are decided through comprehensive judgements which consider many factors.

7.4 Individual performance review and pay review process

This section concerns the individual pay review process in the UK case firms corresponding to section 6.4 (formal appraisal system), and section 6.5 (individual appraisal process in real setting) for the Japanese case firms. On the one hand, the appraisal (*jinji kouka*)⁹⁶ process was given focus on the Japanese side, since ratings in appraisals are directly linked to individual pay determination in the Japanese case firms. This means ratings of appraisal determine appraisal-related pay increase (*satei shoukyu*), and appraisal and individual pay review is an identical process. On the other hand, on the UK side, both performance review and individual pay review are discussed, since the performance review is one of the inputs of the pay review, and they are separate in the UK case firms.

7.4.1 Formal individual pay review procedure

The payment systems studied in all of the UK case firms are for employees whose pay levels are determined through individual pay reviews. The individual pay review procedure in the case firms is described below. They share the same basic procedures, but details differ.

Individual pay review process

- Line managers decide ratings in performance reviews
 - ↓
- Corporate HR decides the pay budget for the next year and sets the guidelines for the pay increase rate according to rating categories (pay increase rates are sometimes differentiated by division, employee level and job family)
 - ↓
- Individual pay reviews for annual pay levels of next year by line managers
 - Factors such as the results of performance reviews, market pay rates and relative position compared with market pay rates are considered in these reviews

As indicated, line managers review their members' pay unlike Japanese case firms that

⁹⁶ Word 'appraisal' is used to express *jinji kouka* in Japan. Content of *jinji kouka* is indicated in section 3.3.6 in chapter 3 and Appendix IV.

corporate HR reviews individual pay levels.

The discussion in this section is based on information obtained from corporate and divisional HR and employees (line managers and non-line managers). Contents of the research for corporate and divisional HR, and employees were discussed in chapter 5. Divisional HR practitioners were interviewed in Company BT1 and Company BT2, and employees were interviewed in Company BT1, Company BT2 and Company BR1. The number of HR interviewees in corporate and divisional levels, and employees is indicated in table 7-7.

Table 7-7: Number of HR and employee interviewees

	Corporate HR	Divisional HR	Line manager	Non-line manager
Company BT1	3	1	4	2
Company BT2	4	1	5	2
Company BR1	3	0	1	1

Whilst the individual pay review process in a real setting discussed in this section is limited to the three firms where divisional HR and employees were interviewed⁹⁷, discussion of formal performance reviews and pay review systems covers all of the UK case firms.

In the previous section, output performance and competency were discussed separately as different aspects within the person factor. However, this section does not separate output performance and competency, because these factors are not separated in pay reviews and overall ratings in performance reviews in the UK case firms. In particular, in pay reviews, judgement is comprehensive and includes many factors that assess the overall value of individuals including the assigned job value and person value.

7.4.2 Performance management

Firstly, performance review is discussed. All case firms have implemented performance management and individual contributions such as output performance and competency are assessed through a performance review. Performance reviews are the only one assessment tool which operates in relationships between line managers and their

⁹⁷ Divisional HR was not interviewed in Company BR1.

members, unlike Japanese cases where at least two types of appraisal related to pay operate in the line relationships. Moreover, as the only assessment tool which operates in relationships between line managers and their members, the performance review includes both judgement and development components. The setting of objectives and review of performance are the focus of the performance management process in the UK case firms, as in the Japanese case firms.

(1) Setting objectives

Objectives are set as bases of judgement of contribution -- mainly output performance. Objectives are set through face to face meetings between line managers and individual employees (often combined with a performance review meeting). According to line manager and non-manager interviewees, before the meeting line managers inform objectives of their departments or sections individually and/or collectively. Individuals and line managers develop ideas about objectives before the meeting. There are two methods of setting objectives. One is cascading corporate objectives to individual objectives. One is basing objectives on the accountability or tasks of the job concerned.

Although the case firms use these two methods, they do not emphasise the method of setting objectives based on job accountability. When the author asked the interviewees in the case firms about how to set objectives, at first both HR and employee interviewees pointed out the cascading process. After successive questions such as how objectives of department or section are allocated to individuals, they answered that this based on accountability or areas of tasks of individual members. Objectives based on job accountability may be taken-for-granted by them. Although they did not emphasise this, it is a significant difference to the Japanese case firms.

All case firms require agreement on individual objectives between line managers and individuals, although the degree of requirement differs among the case firms. According to employees interviewed, they have mostly agreed to the objectives, because objectives are not largely divergent from their tasks. If objectives are different from areas and levels of tasks assigned, their pay often increases since it is regarded that their job levels have changed. Line managers change job descriptions according to change of job content. If changes of job content accompany changes of pay levels, pay levels are increased for promotion adjustments. This is the usual practice according to HR and line

manager interviewees. If objectives and/or tasks change during the performance management period, the same procedure is applied. This is also the usual procedure. These practices in the UK case firms are also significantly different from the Japanese case firms where the annual pay review is the only pay increase opportunity in a year.

(2) Performance review

In the performance review, each item in output performance and competency is assessed according to ratings in seven firms⁹⁸ except Company BC1. Company BC1 assesses according to word descriptions and not by ratings. Among seven of the case firms, all of them except Company BT1 decide overall ratings in the performance review. Company BT1 does not have overall ratings. Only individual items within performance and competencies are assessed according to five categories⁹⁹. Categories in overall ratings in the case firms are summarised in table 7-8.

Table 7-8: Overall rating categories in case firms

Case firm	Rating category
Company BT1	No overall rating. Individual items are rated according to 5 categories; Outstanding, Exceeds expectation, Meets expectation, Development/improvement needed, New to Role
Company BT2	6 categories; Outstanding, Exceeds objectives, Met objectives, Met most of objective/needs improvement, Not met objectives, Unable to Rate.
Company BF1	9 categories; Choice from 9 boxes ¹ as part of a matrix of three categories on output performance (Exceeds Expectation, Meets Expectation, Needs Improvement) and three categories on competency (Exceeds Expectation, Meets Expectation, Needs Improvement).
Company BF2	4 categories; Choice from 4 boxes as part of a matrix of two categories on output performance (Exceeds Expectation and Needs Improvement) and two categories on competency (Exceeds Expectation and Needs Improvement)
Company BF3	5 categories; Exceptional, Excellent, Good, Development/Improve, New to Role.

⁹⁸ Information about competency assessment was not gathered from Company BO1.

⁹⁹ In Company BT1, the global head office located in the UK assesses overall ratings. But the UK operating company does not.

Company BR1	7 categories; Outstanding, Excellent, Good, Developing, Incomplete, Unsatisfactory, Cannot Assess.
Company BC1	No ratings.
Company BO1	5 categories; From A (highest) to E (lowest)

¹ In Company BF1, ratings are categorised into 9 by matrix from A to I illustrated in the below figures.

Competency	Performance			
		Exceeds Expectation	Meets Expectation	Needs Improvement
	Exceeds Expectation	A	B	C
	Meet Expectation	D	E	F
	Needs Improvement	G	H	I

While six firms decide overall ratings, no case firms operate forced distribution. As a result, most employees are rated in the mid-rating categories. For instance, in Company BR1, 60% of employees are rated 'Good' (mid category) and 80% of employees are rated in the mid three categories of seven. According to the case firms, the reason for not being any forced distribution is that where forced distribution is implemented, some employees must be rated low if performance of their team member is generally high, even though their own performance is not necessarily low. This is unfair. The opposite can also happen and this is also unfair. The no forced distribution policy is different from that in the Japanese case firms. Why this difference occurs will be discussed in the next chapter.

The individual performance review process is described based on interviews with line managers and non-line managers. Some line manager interviewees gather information on the contribution of their members from other team members and other related persons prior to the performance review. Information gathering starts a few months or weeks before the performance reviews. The reason for this information gathering is that the line managers cannot capture all aspects of their team members. Some line managers expressed the importance of precise performance measurement not only for judgement purposes but also for recognition. Recognition aids the retention and motivation of employees.

Line manager and non-line manager interviewees generally spend between a half and one day on preparation of a performance review meeting (per interviewee for line managers). Before the meeting, line managers have an idea of the rating, but they finally decide during or after the meeting. Two line manager interviewees said that they pencil in

ratings and rewrite in pen after the meeting. Performance review meetings take about 2 or 3 hours (or a half of one working day) for most interviewees. This length of time is different to the practices in the Japanese case firms where an appraisal meeting is often about 15 to 60 minutes.

All case firms require line managers to feedback the result of the performance review, and all line manager interviewees said that they gave employees the result of the performance review, including ratings, and all non-line manager interviewees said that they received feedback. The general situation regarding feedback cannot be conclusive from the small number of interviewees. However in at least six case firms (Company BT1, Company BT2, Company BF1, Company BF2, Company BF3 and Company BR1) where the performance review forms were gathered, reviewers and reviewees are required to sign them and comments are added to the performance review forms. According to HR interviewees in these firms, not all reviewers or reviewees fill in their comments, but all sign them. Reviewers must show to reviewees performance review forms that the ratings have been filled in order for reviewees to sign the forms. This performance review practice surprised the author who only has direct working experience in Japan. The widespread practice in Japanese firms is that appraisers read the self appraisal form, but appraisees have no opportunity to see appraisal forms that the appraiser's ratings are filled in. This is normal practice in Japan, including within the case firms. Interviewees in the Japanese case firms, except in Company JT3 (UK-owned subsidiary), were surprised when the author told them of this performance review practice in the UK case firms. This is because Japanese interviewees cannot imagine disclosure of appraisal forms on which ratings and other comments by appraisers about appraisees are filled in, since there are no such practices in Japan. Not disclosing ratings and other comments to appraisees is taken-for-granted by the Japanese interviewees.

Regarding the agreement of reviewees on the result of their performance reviews, line manager interviewees said that they agreed with the ratings with reviewees all or most of the time. All of the non-line manager interviewees also said that they agreed with the ratings all the time. Divisional HR interviewees in Company BT1 and Company BT2 said that most employees agree with their ratings in performance reviews in their divisions. An HR interviewee in Company BT1 mentioned that self rating is generally harsher than ratings by managers according to comparisons between self review ratings

and performance review ratings by line managers. From these facts, it seems that the incidence of agreement on performance reviews may be high.

Another reason why the author feels that the degree of agreement is high is that the case firms do not use forced distribution, and most employees are categorised as 'Good' or 'Meet Expectation'. It is understandable that many employees agree with such generally good ratings.

7.4.3 Pay reviews

The pay review in the UK case firms is a separate process from the performance, review unlike in the Japanese case firms. In the UK case firms, the performance review is one of the inputs for the pay review. The UK firms emphasise the performance review as being the important factor for decisions on pay and they set guidelines for pay increase rates according to rating categories. For example, Company BT1 sets a guideline for pay increase rate of 0-4% for 'Needs Development/Improvement', 5-7% for 'Meets Expectation' and 8-10% for 'Exceeds Expectation'. However, line managers also consider other factors such as market pay rates, relative position to market pay rates, ratings in performance reviews, and years of service in the current job, career opportunities and the labour market situation of each job area. In other words, a pay review is a comprehensive judgement which considers many aspects of an individual's value. According to line manager interviewees, the most important factors in pay reviews are market pay rates and contribution.

Establishing the precise market pay rate is critical for retention of employees. The retention problem is more serious for skilled workers who are difficult to replace. Many line manager interviewees said that they had lost highly skilled employees due to job hopping. In fact, non-line manager interviewees answered that the market pay rate is used as one of the criteria for retention. However, it is difficult to decide the proper market pay rate for skilled workers, especially when jobs are not popular. Two line managers said that setting proper market pay rates is the most difficult task. Since most of their employees' jobs are not popular, there is no matching pay data in market salary surveys. They must decide market pay rates through a mixture of pay rates for similar jobs.

At the same time, line managers interviewed emphasised that pay should be in accordance with current contribution levels. This is very important for the motivation and retention of employees. Precise judgement on individual contribution is also a prerequisite for finding proper market pay rates. Even though formal job content may be the same or very similar, practical job content may be differentiated by job incumbents, in particular senior jobs or job that require a high level of skill and knowledge. Therefore, judgement on contribution and judgement on market pay rates are related to each other.

Pay is unilaterally reviewed by line managers, unlike the performance reviews, where employees express their opinion before the final decision is made. Concerning the agreement by employees to the result of the pay review, the proportion of employees who agree with the results of their pay reviews may be lower than the proportion of employees who agree with results of their performance reviews. For example, divisional HR in Company BT2 said that in her division, 70% of employees agreed with their pay review results whilst 30% did not agree with their pay review results in their 2000 annual pay review. The proportion of employees who agree with the results of pay reviews differ each year according to the average pay increase rate of the firm. Company BT1 asked employees who left the firm why this was. A low pay level is one of the reasons.

We cannot draw a conclusion from these facts, but it seems reasonable that the proportion of agreement with pay reviews is lower than that with performance reviews because many employees take 'Good' or 'Meets Expectation' in performance reviews in the UK case firms.

Whilst agreement on pay review results may be lower than agreement on the performance review, one feature captured from the performance and pay review processes in the UK case firms is that a large divergence between contribution levels and pay levels was not found unlike in the Japanese case firms. The correlation between contribution levels and pay levels may be higher in the UK case firms than the Japanese case firms and the reason for this difference will be discussed in the next chapter.

7.5 Payment system in Company BT2

This section discusses the payment system in Company BT2 (one of the UK case firms). The purpose is to discuss payment systems in a more detailed way as in the case Company JT1 in chapter 6. The discussion is limited to the payment system and other related issues such as the business situation until the case study was completed .

7.5.1 Overall description on Company BT2

(1) History of Company BT2

Company BT2 started its business in 1852 as a telegraph cable service between London and Dublin. Later Company BT2 expanded its service areas to become an international network service provider, especially in the former British colonies. In 1928, Company BT2 expanded its service area into telephone networks by merging with the firm established by the inventor of telephone technology. In 1947, all shares in Company BT2 were transferred to the government. In 1948, Company BT2 made an agreement with the government of Hong Kong to provide external telecommunications for the colony. As telegraphy became obsolete in the 1950s, the development of coaxial voice transmission offered the chance to switch over to telephone cables. By the early 1980s, Company BT2's largest operation was in Hong Kong, where the international telephone service it operated provided 88% of its profits. In the early 1980s, Company BT2 underwent a major change as the UK government sold all of its shares to the private sector by 1985. Company BT2 has invested in new ventures since the 1980s. For example, it launched Mercury Communication Ltd. Mercury's business was in the more profitable areas of long distance and business communication, so that it was able to generate about 25% of Company BT2's turnover. However, despite diversification, Hong Kong business remained central to its profitability. The firm endeavoured to cooperate with the Chinese government to prepare for its takeover of Hong Kong in 1997. In the 1990s, Company BT2's main objective was the completion of what is called the global digital highway linking the centres of the world economy through fiber optic cables. In 1993, Company BT2 initiated another venture, Mercury One 2 One, which provided a digital cellular service in the UK. Mercury faced increased competition from newcomers scrambling for market share after the 1991 deregulation (abolition of the duopoly policy for the fixed phone market in the UK). Mercury ran

into trouble from increased competition, causing Company BT2's stocks to underperform in 1995. In 1997, when Hong Kong was taken over by China, Hong Kong business provided two-thirds of Company BT2's profit.

(2) Change of organisation strategy¹⁰⁰

The appointment of a new CEO in 1999 led to a change in organisation strategy. Before the change, business areas included fields such as public communication (including international and domestic fixed line, and mobile telephone services) facsimile and data transmission services, leased circuits, and sales and rental of telecommunication equipment manufactured by others. However, after the change, Company BT2 focused on the provision of high performance global Internet Protocol (IP) and data services to business customers. One of the main reasons for the change was that it became necessary to concentrate on the core business, since much larger amounts of investment were now required in areas such as the construction of communication lines and development of contents for the provision of data and multi-media. Furthermore, Company BT2 changed its focus on global markets to the US, Europe and Japan. As a result, Company BT2 withdrew from many markets. Its largest divestment was the Hong Kong business, which made the largest profits. This was because the US, Europe and Japan are the largest markets. In particular, these three areas are the largest and they have the highest potential for new business areas targeted by Company BT2 in terms of data services to business customers through IP networks. As a result, the firm's organisational structure changed. It divided into two large divisions; one is 'Company BT2 Global' dealing with the three main markets of the US, Europe and Japan, and the other is 'Company BT2 Regional' dealing with other areas in the global market.

7.5.2 Overall description of the reward system¹⁰¹ in Company BT2

(1) Restructuring the financial reward structure on a global scale

Accompanying the change in organisation strategy, Company BT2 has been developing

¹⁰⁰ This thesis uses word 'organisation strategy' including corporate and business strategies and functional strategy except HR strategy.

¹⁰¹ This thesis uses 'pay' (payment for work) and 'payment system' (procedure for calculating employees' pay). However, this 'payment system in Company BT2' section uses reward or financial reward in accordance with words used by Company BT2.

a globally consistent financial reward structure. In other words, Company BT2 has been developing elements of financial reward which will be globally applicable. The following elements and principles for each element are applicable to all employees on a global scale.

Base-pay

Base-pay is set as an average of the market median. Pay reviews are driven by market rates and individual performance¹⁰². As a guideline, in setting pay levels in comparison with market pay, meeting objectives is set at market median level and outstanding or exceed objectives is set as the upper quartile of market pay. As base-pay levels adapt to local markets, pay levels of employees with the same level of responsibility differ between countries.

Short Term Incentive Plan =STIP (annual cash bonus)

This is determined by the overall company, business unit and individual performances.

Share options

There are two types of share options; one is all employee share option (SAYE scheme in the UK) and the other is a discretionary share option, the allocation of which is determined by management.

Employee benefits

Contents of employee benefits differ between countries.

In the UK, commission and other types of incentive schemes for sales and share purchase plans for all employees are added to the global financial reward structure. In the UK, the same financial reward system is applied to employees, while the financial reward system for GSM (global senior managers)¹⁰³ is somewhat different from other employees.

¹⁰² This thesis uses word 'contribution' to indicate individual performance including output performance and input performance. This 'payment system in Company BT2' section uses the word 'performance' to indicate individual performance, including output performance and input performance, in accordance with the use of the word by Company BT2. It should be added that Company BT2 uses the word 'performance' without a strict distinction between the output and input aspects, and the word 'performance' often includes both output and input aspects, but Company BT2 emphasises more output performance than input performance in relation to financial reward.

¹⁰³ GSMs are employees whose job size is more than 1200 points determined by the Hay Guide Chart point factor job evaluation. The number of the GSMs, including board members, was 85 at the time of interview about the GSMs (2001).

(2) Purpose and principle of reward system in the UK

The above description is about elements of financial reward and principles for each component as applied on a global scale. The following discussion is about the reward system in the UK. Firstly, purposes and principles of the reward system in the UK are discussed, as Company BT2 set several purposes and principles for the design and implementation of its reward system.

Whilst there are various purposes of the reward system, Company BT2 particularly emphasises two: one is the attraction and retention of talented individuals who Company BT2 needs to deliver its business objectives, and the other is the establishment of a performance culture. Regarding the former, the attraction and retention of talented individuals are essential to achieve business success in increasing market competitiveness. In the past, the focus was on the retention of all employees, but the focus shifted toward retaining only talented employees.

Regarding the latter point, Company BT2 thinks that a performance culture has become more crucial in the changing business environment. Price competition has been increased and profits have been quickly decreasing in the traditional telephone service that was the main business area of Company BT2. Company BT2 changed its business area towards concentration on data communication services through IP as described above. However, targeted business is a new business area and it is only in its primitive stage. Therefore, Company BT2 needs to invest on a large scale, but profits from the businesses are still small. That is, Company BT2 must take a high risk for a currently low profit business. In fact, the voice phone business is still the main source of profits. While Company BT2 is concentrating on data communication services through IP and divested itself of other areas in the US, Europe and Japan, it still has interests in the voice phone business in other countries that 'Company BT2 Regional' deals with (one of the two large divisions in Company BT2 as indicated above). However, profits from the voice phone business will probably decrease in the future, because this business area faces strong cost competition around the world. Hence, Company BT2 must achieve business success in its targeted main business of providing data communication services through IP in order to survive, even though the development of this business is difficult, surrounded by a lot of uncertainties. A performance culture is essential in these circumstances.

Company BT2 set several principles for the reward system in order to achieve the reward purposes. The first was an emphasis on a total reward approach including intrinsic and extrinsic rewards (extrinsic reward includes financial and non-financial reward). The total reward approach is important to retain talented individuals. Corporate HR identified elements constituting total reward and then tried to establish the concept and specific contents of the total reward for its members across the organisation, especially for line managers. If line managers understand the elements of the total rewards, they can use and combine various types of reward as the total package, and offer tailor-made packages according to an individual's preferences. HR practitioners think that this increases the effectiveness of rewards, and contributes to the attraction and retention of talented individuals.

The second principle is creating a direct link between individual rewards and corporate and individual business performance. Company BT2 sets three levels to measure performance: corporate level, divisional level and individual level, and decides the relationship between the three levels and each reward element. Achievement of corporate performance is linked to short term incentive plan (STIP) and discretionary share options. There are various methods to measure corporate performance linked to either the STIP or discretionary share options. Divisional performance is linked to the STIP and is measured by regular customer satisfaction surveys. Individual performance is linked to base-pay, STIP and discretionary share options. Individual performance is assessed through the performance review that includes output performance and competency assessment based on corporate values expressed in the 'Way We Work Value'. In terms of individual performance, Company BT2 has a policy of clear distinctions of reward levels between truly high performance and 'meet objective' levels.

Thirdly, reward is linked with an individual's market value. Reward in this case indicates base-pay. Employees' skills and knowledge are translated into a monetary value as indicated by market pay rates for their jobs. Reward linked to individual market value is necessary for the attraction and retention of talented individuals. As such individuals have a high market value. If Company BT2 fails to offer market competitive pay to such individuals, it cannot attract and retain them. Therefore, base-pay should be determined against market pay rates.

The fourth is demonstrating a fair and consistent approach to managing the process for reward determination. Company BT2 considers that a fair and consistent approach is essential for the achievement of reward purposes. Company BT2 sets various policies to achieve fair and consistent approach such as implementing performance management that includes participation by employees including setting objectives and a review process, line manager training for performance management and reward management, and conducting employee opinion surveys. Specific processes or detailed contents will be discussed later.

The fifth is increasing flexibility for the total reward. Company BT2 considers that total rewards should be individual as its employees are individuals. A specific approach for this principle is the use of flexible benefits.

A specific policy for each reward element is developed according to these principles. The main reward element discussed here is base-pay, since this thesis concentrates on base-pay among various elements of a reward or payment system. However, this section briefly discusses two other financial reward elements; STIP and discretionary share options. This is because Company BT2 regards these three elements -- base-pay, STIP and discretionary share options -- as one set within the total reward. According to the concept of total reward in Company BT2, financial reward (extrinsic reward is divided into financial reward and non-financial reward such as recognition, advancement and participation according to the concept of the 'total reward approach' in Company BT2) is largely divided into two areas; one is reward determined through individual assessment and the other is reward not related to individual assessment. The former type includes base-pay, STIP and discretionary share options, and the latter includes pensions, healthcare, all employees' share options, a share purchasing plan and other types of employee benefits.

For the latter type, Company BT2 tried to minimise differences among employees. All types of employee benefits are available to all employees, although benefit levels are different in some benefit schemes, such as pension level, according to base-pay levels. Company BT2 has a policy of minimising barriers across the organisation, including barriers between employees, because barriers within the organisation have many bad effects including hindering communication and cooperation between divisions or

employees, and decreasing employee commitment to the achievement of organisational objectives. As a result, organisational performance suffers. Differences in employee benefit can create an unnecessary barrier within the organisation. Therefore, differences in employee benefits due to such things as employee levels should be minimised. For example, Company BT2 abolished the company car (status car) several year ago¹⁰⁴.

This employee benefit policy in Company BT2 is quite different from some other case firms. For example, Company BT1 differentiates employee benefit levels such as a company car, pension and healthcare. Company BT1 considers that employee benefit is also reward determined through assessment, although the assessment is indirect or long term assessment determined by promotions. In other words, if employees are highly assessed, they are promoted to higher employee levels, and they can get high levels of employee benefits. Then, differences in employee benefits function to increase motivation in the same way as other types of financial rewards. Hence, Company BT1 thinks that employee benefits should be differentiated by employee levels.

Concerning three elements of financial rewards -- base-pay, STIP and discretionary share options -- Company BT2 has a contrasting approach to employee benefits. Company BT2 thinks that these three elements, determined through individual assessment, should be highly differentiated according to the result of an individual's assessment. Further, Company BT2 treats these three elements as one set. That is, if individual performance is not fully rewarded by base-pay, individuals are rewarded by other methods such as the STIP and discretionary share options. For example, even though individuals receive high ratings in their performance review and line managers recognise their high performance, if their base-pay levels reach the maximum level against market pay rates according to the guidelines set by corporate HR, their base-pay levels do not increase. Instead, high performance is rewarded by STIP and/or allocation of shares as discretionary share options. This thesis includes the STIP and discretionary share options reflecting these reward policies in Company BT2 as part of the 'payment system in Company BT2'.

¹⁰⁴ There are other reasons for the abolition of the company car. For example, maintenance costs of company cars are very expensive especially, as tax for company cars has recently been increasing. Instead of abolishing company cars, Company BT2 offers cash compensation for employees whose annual pay levels are more than £35,000. Because, most large firms in the UK offer a company car for this employee level according to benefit surveys, if Company BT2 does not offer cash compensation, it would have recruitment and retention problems at this employee level.

7.5.3 Base-pay

(1) Principle for base-pay determination

Base-pay is the central element of the reward package in Company BT2. Other allowances and rewards (STIP plan, pension scheme contribution and share options etc.) are calculated based on base-pay. The principle to determine base-pay is that base-pay is based on the skills required and the value of the job an individual fulfils. Base-pay is determined by reviewing relative pay levels inside and outside of the business and by work of similar scope, responsibility and impact (in the pay review for existing employees, individual performance is considered as well as these factors). When new employees are recruited, base-pay levels are set by the market median of jobs of the employees. This is the general policy, and if line managers judge that skills are in high demand in the market place, higher levels of pay can be provided for the employees than the market median level. When company BT2 decides to recruit new employees, it offers employment conditions, including base-pay levels, to individuals. If the individual agrees with the offer, they enter into an employment contract. Contents of and changes to the base-pay system are discussed below. The discussion is divided into job, market and person factors (the basic factors constituting payment systems identified by this thesis) because Company BT2 considers three factors for individual pay determination.

(2) Job factor

As mentioned above, the principle to determine base-pay is that base-pay is based on the value of the job, assessed internally and externally, and on the skills required by the job. Therefore, the job is the basis for individual pay determination.

Job evaluation

Company BT2 used point factor job evaluation. But it changed from this job evaluation method to a non-analytical job evaluation based on brief job descriptions plus market pricing about 10 years ago. Brief job descriptions include elements such as job title, main responsibilities, reporting level, main tasks, required experience, skills and

qualifications. Company BT2 regards this new job evaluation method as market driven pay determination, although it has not decided on a formal name for the new method. The new method will be described in the 'market factor' section.

There are various reasons for this change, the two main ones being indicated. The first and most important reason is increasing flexibility and adaptability for a quickly changing business. Since the 1980s, the speed of technological change in the telecom business has been increasing, and new businesses were quickly generated by the quickly changing technology. As a result, Company BT2's business areas have been changing more quickly than in the past. For example, the construction of fiber optic cables on a global scale became urgent in the early 1990s, and Company BT2 did this using various methods, such as its own investment or through alliances. Technological change accelerated business globalisation and market competition on a global scale. In the 1990s the mobile phone market quickly expanded. Company BT2 invested in a new mobile phone firm through a joint venture. Moreover, since the late 1990s, the speed of technological change has become even faster. This has been further accelerating market competition in the telecom business and accelerating business change in Company BT2.

The government policy of deregulation also changed the business environment from a relatively stable one to a more changing environment. Until the 1970s, Company BT2 was a public-owned firm. Although the government sold its shares by the mid 1980s, the government had a duopoly policy for the fixed phone market in the UK. This decreased market competition for Company BT2. But the government abolished this duopoly policy in 1991. After that, many newcomers entered the fixed phone business and this increased market competition. As Company BT2 faced fierce market competition, it had to change business areas in order to adapt to market needs that became more demanding with technological progress.

Furthermore, the political situation of the takeover of Hong Kong by China was also a reason why Company BT2 faced greater market competition and this led to a change in the business areas of Company BT2. This was because Company BT2 had monopoly of the Hong Kong telecom business, and it made two-thirds of its profits from the Hong Kong business until the mid 1990s. But Company BT2 lost its monopoly and other telecom firms entered Hong Kong. As a result, profit from the Hong Kong business decreased.

All of the changes indicated above increased the speed of change within Company BT2. Job or employee profiles changed more quickly. Now Company BT2 reviews its jobs within the organisation every 6 to 12 months. In order to adapt to this quick changing business situation, pay determination had to be highly adaptable. The time consuming nature of point factor job evaluation is not compatible with this quick changing business situation. If Company BT2 determines individual pay levels based on the point factor scheme, when the pay structure is created many jobs are already generated and many jobs already disappear. If Company BT2 uses such a method, it cannot achieve the attraction and retention of talented individuals as one of the main purposes for its reward system. Therefore, Company BT2 needed to change its job evaluation method to a method that could adapt to the quickly changing business situation.

The second reason is increasing flexibility and adaptability for the labour market. Market value largely differs between job families or job areas among the same or similar employee levels. However, a point factor job evaluation more focused on internal relativity does not necessarily reflect differences in market value between job families. Moreover, the Hay Guide Chart that Company BT2 used considers factors such as budget size and number of direct report as size to judge impact and influence of the job. Job size identified though this type of point factor scheme tends to have a strong relationship with employee level (hierarchical level). But market value between the same or similar employee levels differs between job families, and Company BT2 had to adapt to the labour market situation in order to attract and retain talented individuals, which is one of the main reward purposes of the Company BT2. Therefore, the point factor scheme is not compatible with it's the reward purpose. Furthermore, the labour market situation changes rapidly with the quickly changing technology and business in the telecoms or high-tech industry with which Company BT2 shares its labour market. Company BT2 had to adapt to this changing labour market situation. Pay determination based on point factor job evaluation with its two characteristic elements of time consumption and focus on internal relativity could not cope with the changes in the labour market.

Pay structure

The pay structure is categorised by job factor, since the pay structure is created based on

the value of jobs. Although the job evaluation method changed, the job is continuously the basis of the pay structure.

The pay structure also changed at the same time as the job evaluation method. That is, a pay structure with a fixed pay range was abolished about ten years ago alongside the change in the job evaluation method. Before the change, each pay band had a pay range with minimum and maximum points. Jobs were slotted into corresponding pay bands according to job size expressed by points identified through the point factor scheme. Whereas in reality all jobs were not necessarily within the pay ranges in corresponding pay bands, Company BT2 tried to put all jobs into corresponding pay ranges as far as possible. However, Company BT2 abolished this type of pay structure and changed to the new pay structure, which has no pay bands for corresponding jobs. Pay levels were determined based on market rates. A specific method for this type of pay determination will be discussed in the 'market factor' section.

There are various reasons for changing the pay structure. The three main reasons are discussed here. The first is increasing flexibility and adaptability of pay determination for a rapidly changing business. As business areas often change in Company BT2, there are often reviews of organisational structure and this accompanies a large number of employee transfers. Furthermore, as the demand for each job changes under changing business requirements, a large number of employee transfers also occur within one division. Therefore, individuals' job content often changes. The change of job content accompanies job promotions and demotions, even though individuals' skills do not change. If Company BT2 changes pay levels according to job promotions and demotions generated for organisational reasons, employees may be dissatisfied and feel this is unfair. Such a reaction from employees can create problems in retaining talented individuals. Therefore, pay levels should not be closely attached to jobs, although pay levels and job content must have a relationship. Company BT2 considers that this problem may occur if pay bands are narrow and rigid. Abolition of pay bands corresponding to jobs is the solution that Company BT2 chose.

The second reason is increasing flexibility and adaptability for pay determination in the labour market situation. If pay bands are narrow and rigid, pay levels tend to be attached to job content. However, market values change by changing the business requirements of the firms with which Company BT2 shares the labour market, even though job

content does not change. Company BT2 must adapt to the labour market situation in order to attract and retain talented individuals. Therefore, pay levels should not be closely attached to job content, although pay levels must be related to job content. Abolition of pay bands corresponding to jobs is the solution that Company BT2 chose.

The third reason is the increasing flexibility and adaptability of pay determination to individual performance. Performance levels are different between individuals with the same or similar job content. Pay levels must be differentiated according to individual performance in order to achieve the reward purposes of attracting and retaining talented individuals, and of creating a performance culture. However, if Company BT2 uses a narrow and fixed banded pay structure, pay levels tend to be attached to job content. Therefore, if Company BT2 has a narrow and fixed banded pay structure, these reward purposes are not achieved.

Although Company BT2 changed its pay structure to a highly flexible structure, this flexible structure made pay administration difficult. For example, Company BT2 wanted to capture approximate pay levels for each employee level. However, even though employee levels were the same, pay levels were largely differentiated between job families or job areas. Capturing the pay levels of each employee level became difficult. The solution was the introduction of a job family pay structure. A job family pay structure makes capturing pay levels at each employee level easier. Furthermore, comparison of pay levels between job families becomes easier. This means that establishing differences in the labour market situation between job families becomes easier. Although Company BT2 implemented a job family pay structure, it is informal in that the job family pay structure is exclusively used for the administrative purpose of HR, and is not communicated to employees. At the time of the case study (2000 to 2002), Company BT2 considered a change of the job family pay structure into a formal structure that is communicated to employees. Because a job family pay structure can align pay with career progression, if employees find their pay positions within the job families, they can easily predict their pay progression associated with career progression in Company BT2. Furthermore, line managers can easily explain the reasons for the pay review results.

(3) Market factor

Company BT2 points out that the market value of individuals, expressed as the value of jobs, and individual performance are the most important factors for base-pay determination. Company BT2 changed its pay determination method from one based on point factor job evaluation towards a non-analytical job evaluation plus market pricing. Sources of market pay rates of Company BT2 are: market salary surveys, contact with other telecoms firms, and monitoring national, local and industry pay movements and significant trends. Among these three types, market salary survey data gathered through participation in various market salary surveys is the main source. Market salary surveys are largely divided into two types: one is where only survey participants can have access to the survey data and the other is where the survey data are available to all regardless of whether they took part in the surveys. Company BT2 bought both types, although the former type which only survey participants can buy (called a club survey) is the main source of market pay. Company BT2 participates in several market salary surveys, and gathers a large amount of market pay data.

A method of gathering market salary survey data is as follows. Market salary survey conducting firms send salary survey questionnaires to survey participants. The questionnaire includes job descriptions that briefly describe each job such as the main responsibility, reporting level, number of direct report and required experience (from the 'Towers Perrin executive remuneration participant guide'). The questionnaire also includes career maps. A career map is largely divided into two types: one is a career map including all major job families and the other is divided by each job family. Furthermore, there are various types of categories for career maps divided by each job family. Each salary survey creates its own categorisation. For example, the Towers Perrin High Tech Survey categorises types of job family into a large category and a small category. The Watson Wyatt Telecom Survey categorises types of job family into a large category, a mid category and a small category. Each type of career map includes a brief description for each job family and each career level within one job family.

Market salary survey questionnaires including the above issues are sent to HR function of participant firms. HR delivers the salary survey data form to job incumbents according to job descriptions indicated in the questionnaire. Job incumbents fill in the data about the following issues; main responsibility, annual pay data (base-pay, date last

reviewed, percentage increase in base-pay (£), eligibility for bonus scheme, actual bonus received (£), target bonus (%), maximum bonus (%), type of other cash payment, car value (£), private petrol (£), incumbent scope data (year of birth, years in office, year assigned this position), job impact (reporting level, approximate total number of direct report), long term incentives (eligibility for share options, maximum individual entitlement, annual target allocation of share options, last allocation of share options etc.) (from 'Towers Perrin executive remuneration participant guide').

After gathering salary data, the firm conducting the survey sends a report with the gathered and analysed salary survey data. There are many types of data in the salary survey and they are largely divided into two; one is analysis for general characteristics of the survey data including names of participant firms and general trends of salary levels such as upper, median and lower quartile for each major job family, and the other is salary data for each job. The latter is the main part of the salary survey. Furthermore, the data for each job are divided into two parts; one is a career map (there are various types of career maps such as a career map of the organisation as a whole, and a career map divided by job families in the same way as in the salary survey questionnaire), and the other is a job description of each job and salary survey data for each job. Salary survey data for each job indicate information such as levels, number of firms, and employees that the salary data were gathered, car eligibility, base-pay without car compensation (lower, median, upper quartile), base-pay adjusted for car compensation (lower, median, upper quartile), total cash package without car compensation (lower, median, upper quartile) and total cash package adjusted for car compensation (lower, median, upper quartile).

Company BT2 participates in several salary surveys, and salary survey specialists in HR function create their own versions of salary survey data based on various market salary survey data. Participation in several salary surveys increases the coverage of jobs in Company BT2 and the validity of survey data for each job. Concerning coverage of jobs, no salary surveys cover all types of jobs in Company BT2. Salary surveys are largely divided into two types: one is the industry specific survey such as the high tech industry survey and telecom industry survey, and the other is the functional survey such as financial function, marketing function and HR function. Therefore, Company BT2 needs to participate in several types of surveys to cover all job areas in Company BT2. Concerning increasing validity of survey data for each job, as each survey defines each

job in a slightly different way, even similar jobs, if Company BT2 gathers the data from various salary surveys, the firm can gather data for each job from a different angle for the same or similar jobs. This increases the degree of matching between jobs in the market salary surveys and actual jobs in Company BT2.

HR delivers salary survey data to line managers – the relevant job family is given to each line manager. Line managers search for matching jobs in the salary survey data using job descriptions indicated in the salary survey. If necessary, divisional HR personally consults with line managers in finding matching jobs. After line managers find the matching jobs (finding jobs is difficult for unusual jobs or jobs requiring high skills and knowledge in practice as will be discussed in the section ‘operation in performance review and pay review’), they compare the pay levels in the salary survey data with their members’ pay levels.

Company BT2 sets its policy for pay review according to this market driven pay determination. That is, pay levels should be within +/- 15 to 20% of the market median for matching jobs. Therefore, line managers are expected to decide their members’ pay levels within this range. If their members’ pay exceeds this range, their base-pay does not increase, even though their performance is high, unless their job content changes and the change accompanies a change in the market pay rates. In such cases, high performance is rewarded by other reward packages such as STIP or discretionary share options. However, this is the basic policy, each line manager making a judgement in each individual case. If they judge a pay increase is needed in order to retain their members, they can set pay levels exceeding 20% of the market median, although approval from corporate HR is needed.

Another purpose for the use of market salary surveys is to review members’ job descriptions. Job descriptions do not necessarily reflect job content precisely, mainly because job content is often changed by business changes and by job incumbents. Therefore, if members’ pay levels are largely different from the matching jobs, the reason may be that the job descriptions do not reflect the members’ job contents precisely. In this case, discussion with each member is needed in order to correct the job description and to set the correct level of pay.

Furthermore, corporate HR sets the career stage for the current jobs as a comparison

ratio against pay levels of matching jobs in salary surveys as follows (cited from internal document of Company BT2).

80-90% - new into role (or role upgraded)

90-100% - people who are developing in the role and gradually increasing their salary through good performance

100-110% - people who have been in the role for a while and are ready for a new role

110-120% - people who are being overpaid for the job, or who have moved to a lower graded job but remain on the same terms, or who have been in the job for many years and cannot progress any further

Divisional HR advises line managers to think of reasons for employees whose comparison ratio against market pay is 110-120%. The reasons may be indicated in the comparison ratio indicated above, or they may be other reasons. HR practitioners think that these career guidelines against market pay rate work effectively, because managers have opportunities to think about why their members' pays exceed 110% or 120% of market median pay rates, this being acceptable if there are good reasons. In addition, line managers are encouraged to make career development plans or improvements in their members' performance according to the above comparison ratio, especially for employees who are being overpaid for the job, unless they are not high performers or have scarce skills.

There is a variety of reasons for the introduction of market driven pay determination. The main reasons are indicated here. The first is increasing flexibility and adaptability in rapidly changing business areas. As indicated in the 'job evaluation' section, business areas in Company BT2 have been increasingly changing. Market pay determination is a good solution. The second reason is the increasing flexibility and adaptability for the labour market. This reason was indicated in the 'pay structure' section.

The third reason is pay cost reduction or increasing pay cost control by prevention of unnecessary pay drift. Until the mid 1980s, Company BT2 was a public-owned firm in which the financial situation was more stable. Although Company BT2 was privatised by 1985, the UK government had a duopoly policy for the fixed phone business in the 1980s. At the time, consideration of pay levels with BT as reference to market pay was sufficient for pay determination in Company BT2. Therefore, internal organisational

factors such as internal relativity were focused upon in pay determination at the time. A pay structure based on a point factor scheme was a suitable method at the time. In BT at the time, pay levels increased annually even for employees who continuously worked in the same jobs. As a result, many employees reached maximum points in pay ranges to which their jobs correspond, and pay drift often happened. As Company BT2 considered pay levels in BT for pay determination, pay drift often happened similarly. However, Company BT2 could afford pay drift, because market competition was not strong. In other words, Company BT2 could increase consumer prices if pay costs or other costs increased. However, the government abolished the duopoly policy in 1991. After that many newcomers entered the telecom business and Company BT2 now had many competitors. Company BT2 could no longer afford unnecessary pay drift. Market driven pay is good solution to prevent unnecessary pay drift. Even though job contents change, if the changes do not accompany change of market pay rates, pay levels do not change.

(4) Person factor

Company BT2 places emphasis individual performance for pay determination, and individual performance is assessed through the performance review within the performance management cycle. Although this section uses the word 'performance', including both output and input performance in accordance with the use of the word in Company BT2 as indicated in earlier foot notes, output and input performance are treated separately in this section. This is because output and input performance (as competencies) are reviewed and rated separately in the performance review, although they are mixed in the overall ratings.

As the performance review is one area within the performance management cycle, this thesis firstly describes the formal performance management cycle. The performance cycle starts in April and finishes in March (one performance management cycle is one year). Performance in the last year is reviewed at the end of year performance review meeting, conducted in the following April, for the last year. Also new performance objectives (output performance) are set and a personal development plan is decided in the end of year performance review meeting in April. Both the performance review and the setting of new objectives are decided through face to face meetings between the line manager (reviewer) and individual members (reviewees). During the performance

management cycle, a mid-year performance review is conducted once (in October) and a mid-year development review is conducted twice (in July and January).

Before the meeting, employees complete a pre-appraisal questionnaire and send this to the manager prior to the performance review meeting. Managers read the pre-appraisal questionnaire in preparation for the performance review, and they assess each individual's objectives and overall performance rating. During the meeting managers and employees discuss the degree of achievement of individual objectives, and seek an agreement on an overall performance rating. Managers and employees both sign to express agreement (if they do agree) for the overall rating and add comments on the performance review form. Managers and employees decide new objectives during or after the performance review.

The performance management described above is the formal system set by corporate HR. Practices vary in such areas as contents and frequency of the performance review by individual managers. These variations will be described in the 'operation of performance review and pay review' section. Although performance management practices vary, corporate HR regulates that, as a minimum requirement, the performance review, including the setting of objectives meeting, must be conducted once a year. According to HR practitioners at corporate and divisional levels, all line managers conduct face to face meetings for setting objectives and reviewing performance. Regarding agreement on overall ratings, most employees agreed with the ratings, according to corporate and divisional HR.

Company BT2 also assesses competencies in the performance review. Competencies are indicated as desirable behaviours expressed in the corporate value named the 'Way We Work Value'. The 'Way We Work Value' consists of five categories of customer, action, teamwork, integrity and innovation. Each category contains the competency headline and behavioural indicators. Managers assess employees' competencies based on the behavioural indicators under each competency headline. Results of the competency assessment in the performance review are related to overall ratings in the performance review. The reason for Company BT2 assessing competencies is that not only is the level of achievement of output performance important to ensure long term business success, but also how the output performance is achieved. Even when employees achieve high output performance, if they damage the firm and other employees, these

achievements should not be highly rewarded. Therefore, assessment for how output performance is achieved is important, and competencies provide criteria for the assessment.

Although competencies are assessed based on behavioural indicators and related to overall ratings according to formal guidelines, whether each line manager really assesses competencies based on the behavioural indicators is questionable and whether each line manager really incorporates the competency review into the overall ratings is also questionable (as discussed in 'competency' in section 7.3.3)

The author found interesting differences between Company BT2 and Company JT3 (a subsidiary of Company BT2 and one of the Japanese case firms). According to corporate HR, all line managers assess competencies based on the 'Way We Work Value' in Company JT3. This is because competency assessment is used to increase overall ratings in the performance review. Most line managers change overall ratings from ratings for output performance to a one step higher rating category by adding the competency assessment. One of the reasons for this difference lies in the difference in the number of rating categories, being six in Company BT2 (as indicated below) and nine in Company JT3. However, there may be other reasons for the difference, although the author did not seek them out.

Overall ratings in Company BT2 have six categories: outstanding, exceeded objectives, met objectives, met most objectives/needs improvement, not met objectives, and unable to rate. Company BT2 does not implement forced distribution for ratings. According to HR practitioners, the reason for the no forced distribution policy is that if performance of other team members is generally good, some employees must be rated low, even though their own performance is not necessarily low. This is unfair. The opposite can also happen and this is also unfair.

In practice, about 70% of employees are rated as having 'met objectives'. This shows a strong central tendency. HR practitioners expressed that the central tendency is not desirable mainly for two reasons. One is that ratings should be related to business performance, but if ratings always show a central tendency, the relationship between business performance and ratings should be low. The other is that performance should vary among members, therefore, a strong central tendency means that ratings may not

be clearly reflected against actual individual performance. One of the reasons for this central tendency may be that line managers emphasise a recognition function for the performance review, therefore, rating categories tend to become 'met objectives'. Otherwise, the recognition function does not function well (emphasis on the recognition purpose of the performance review will be mentioned in 'operation in performance review and pay review' section.)

(5) Pay review

In the pay review, job, market and person factors indicated so far are considered and line managers decide the next year's annual pay levels for their members. Company BT2 emphasises three factors as important factors in the pay review: individual performance (as indicated by ratings in the performance review), the firm's performance and ability to pay, and the market rate for the job. With regard to individual performance and market rate, Company BT2 sets brief guidelines on the relationship between performance levels and pay increase rates as follows. High performers who constantly exceed their objectives and employees with scarce skills are in the upper quartile of market pay, middle performers who meet their objectives are in the median of market pay, employees developing in the role and who cannot meet objectives are in the lower quartile of market rates, and low performers who do not achieve objectives have a 0% increase.

Formal procedures of pay reviews by line managers are as follows. Firstly, they complete a performance review after communication of ratings of the performance reviews with members individually. Secondly, they identify matching jobs in the salary survey data. The survey data and guidelines for finding matching jobs are provided by HR practitioners and they personally help to find matching jobs, if line managers need such help. Thirdly, line managers compare pay levels of their members with pay levels of matching jobs in the salary surveys. Fourthly, internal comparison is made between members of line manager's team and between employees across the organisation. Internal comparison is achieved through relative position against market rates between employees. If a large discrepancy is found in the internal comparison, pay levels are coordinated through cooperation between line managers and HR practitioners. However, this coordination does not necessarily mean evening out the relative position against market rates among employees. If there are reasonable reasons for the discrepancy, the

differences are accepted, for example, if employees are recognised as high performers and/or possessing highly valuable skills, divergence of relative position against market rates from other employees is accepted. Furthermore, divergence between different divisions and/or different job families sometimes happens. For example, annual pay increase rates are not necessarily the same among divisions and/or job families. Company BT2 decides through discussion between the CEO and HR whether or not it has annual pay increases in this year. If they decide to conduct an annual pay review in this year, the next decision is whether or not pay is reviewed only for selected employees or only for some divisions or only some job families or for all employees across the organisation. If they decide that the pay of all employees is to be reviewed across the organisation, the next decision is whether the same pay increase rate is applied across the organisation or an average pay increase rate is differentiated between divisions or job families. Therefore, an average pay increase rate can be differentiated between divisions and job families. Then, line managers allocate pay increase rates among their members within the budget and finally, after the decision for individual pay reviews, pay increase rates and reasons for the pay increase rate are communicated with employees.

Next are the pay review results during the case study (from 2000 to 2002). In the 2000 annual pay review, the average pay increase rate in the UK was 4%. Individual pay increase rates were between 0% and 30%. One person received a 30% pay increase, 10% received a 20% pay increase and most employees received a 3% pay increase. The problem is 2001. There was no annual pay review in 2001 due to poor business results. EBITDA (Earnings Before Interest, Tax, Depreciation and Amortization) decreased from £2,467M (2000) to £1,782M (2001). Earnings per share decreased from 153.6p (2000) to 96.4p (2001). This lack of annual pay review in 2001 created dissatisfaction among employees. This will be described in the section 'operation of performance review and pay review'.

7.5.4 Other financial rewards

As noted earlier, this section in the case study of Company BT2 includes STIP (Short Term Incentive Plan) and discretionary share options.

(1) Short Term Incentive Plan = STIP (annual cash bonus)

The Short Term Incentive Plan (STIP) is linked to organisational performance and to individual performance. The condition for the payment of the STIP is 95% achievement of the targets set for overall financial EBITDA and revenue performance of Company BT2 on a global scale (overall Company BT2 financial performance). If Company BT2 achieves 95% of the targets, the STIP takes place. Three conditions are set for the rate of the STIP; overall firm performance, divisional performance (measured by regularly conducted customer surveys) and individual performance decided by rating categories in performance reviews. Customer surveys are conducted in each country, and divisional performance in relation to the STIP is at each country level.

The reason for the payment of the STIP is to align employees' rewards with the achievement of the firm's business success. In doing so, employees' commitment and motivation for the achievement of business success will increase. However, Company BT2 also thinks that individual performance should be related to the STIP as well as organisational performance in order to prevent free rider problems. Creating a link with individual performance is also important for attracting and retaining talented individuals and for facilitating a performance culture.

Once the firm achieves financial targets and payment of the STIP is decided, the level of payment of the STIP is decided against the degree of achievement of the financial targets, levels of customer surveys and rating categories in the performance review. Regarding the relationship between individual performance (determined by rating categories in the performance review) and rates of the STIP, the following conditions are set: outstanding -- the STIP rate increases by 25%, exceeding -- the STIP rate increases by 15%, met all objectives -- the STIP rate is not changed; meeting most objectives -- the STIP rate decreases by 30%, and not meeting objectives -- no payment of the STIP.

Furthermore, the rate against annual pay levels differs according to employee levels. Company BT2 divides employee levels (below the Global Senior Manager identified by job size through the Hay Guide Chart job evaluation scheme) into three: senior manager, manager/professional (professional includes areas such as HR business partner, legal, accounts) and non-managers. Further, Company BT2 sets approximate annual pay

levels for the three categories; above £75,000 for senior manager, between £35,000 and £75,000 for manager/professional and below £35,000 for non-managers. Categories of senior manager, manager/professional and non-managers are used only for the STIP purpose. The three levels are categorised by report levels plus jobs that Company BT2 decided as being important job and/or required high skills. The direct reason why Company BT2 divides these employee levels as categories of the STIP is the result of a benchmarking exercise against the market situation. That is, market pay says that employees with high base-pay levels tend to get high levels of incentive pay. Therefore, Company BT2 decided to pay more to employees with high pay levels in order to adjust to the market situation. This is necessary to attract and retain talented individuals. As a more theoretical reason, Company BT2 points out that higher level employees have more influence and responsibility for the firm's performance. Therefore, their interest should be more in alignment with the firm's performance.

In 2001, the rate of the STIP was higher than in other years due to no annual pay review in 2001. The average rate of the STIP against annual pay differs according to employee levels: 10% of annual pay for non-managers, 20% of annual pay for managers/professional and 30% of annual pay for senior managers. In normal years, the STIP rates against annual pay for the respective employee levels are 5%, 12.5% and 20%.

(2) Discretionary share options

Company BT2 has two types of share options; a discretionary share option and an all employee share option (SAYE scheme in the UK). Company BT2 treats these two types of share options differently, as discussed earlier. Here I mention only the discretionary share option. The discretionary share options are granted only to key employees who are recognised as high performers or as possessing scarce skills. Each line manager identifies these key employees and provides a justification to the senior business unit manager. Rates of allocation against annual pay levels are between 25% and 100%. Each line manager also identifies the rates of allocation for each employee recognised as key employee, and provides a justification to the senior business unit manager. Share options are allocated to the selected key employees every three months.

These conditions for discretionary share options were set in 2001. Before that,

allocations of share options were larger. However, Company BT2's decreasing share price changed its discretionary share option scheme towards reduction of the allocations in terms of the corporate governance. This is because ordinary share holders are not happy with diluting a large number of shares, especially if the share price is decreasing. Moreover, laws regulate the number of shares allocated as share options against the total market capitalisation. Therefore, Company BT2 had to decrease the number of shares allocated.

Although Company BT2 reduced the level of discretionary share options, it is essentially very keen to use share options. There are mainly two reasons for this. The first reason is to align employees' interests with achievement of the firm's business objectives as indicated in the section on 'STIP'. The second is retention of talented individuals. This is because share options are deferred rewards, and employees must wait and remain in Company BT2 for at least three years in order to sell the allocated shares (Company BT2 sets three years as the minimum condition for exercising share options). This effectively works in the retention of talented individuals. However, Company BT2 also recognises that share options should not be used too much because the value of share options brings risks; it is important not to rely too much on share options as a method of reward.

7.5.5 Operation in pay review and performance review

This thesis has so far discussed the formal reward system of Company BT2. Next is the operation of the reward system focusing on individual pay reviews and performance reviews (the performance review is one of the inputs of the pay review in terms of the person factor). The main source of information for the operation in individual pay determination is interviews of employees (line managers and non-line managers) other than by HR. The results of employee opinion surveys and interviews by divisional HR are used to supplement the information. Furthermore, the author asked HR practitioners at both corporate and divisional levels about their own pay determination process during the interview about Company BT2's reward system. Information from HR practitioners is included in this discussion. Seven employee interviews (five for line managers and two for non-line managers), one in divisional HR (non-line manager) and four in corporate HR (two for line managers and two for non-line managers) were conducted.

Firstly, the pay review is discussed. The most important factor pointed out by line managers are either market pay rates or individual performance or both. Among the line managers, the most important factor is slightly different as either market pay or individual performance. One of the reasons for this difference may be levels and/or types of skills of their members. For example, two line managers (director of construction and maintenance of sub-marine systems and director of development of data communication contents) pointed out market pay as the most important factor for the pay reviews, and identification of precise market pay rates is the most important task for the pay reviews. This is because most of their members are highly skilled and their skills are transferable to other firms. In fact, job hopping often occurs. One of these line managers lost about 30% of his members between 1999 and 2000 due to job hopping. Two line managers (director of system sales for voice and IP service providers and director of system sales for large customers) mentioned that the decision on precise market pay rates is the most important for employees who have transferable skills. They have a wide range of members in terms of skill type from administrative staff to highly skilled staff. They emphasised that offering market competitive pay to members with high levels and transferable skills is critical for their retention. Therefore, market pay is the most important factor for these members. For example, skills for constructing pricing strategies are transferable to other firms and even other industrial sectors. Although specific contents differ between industrial sectors, the principle can be applied to other industries.

Although line managers pointed out the importance of market pay, identification of market pay is a difficult task, in particular for unusual jobs and for members with high skills. In the case of unusual jobs, line managers must create matching jobs by combining several jobs. For example, one line manager said that his members are required project manager's skills, including people management, even at junior level. Therefore, he refers to market pay for management level in this respect. Regarding highly skilled members, their actual job contents are more likely to change from formal job contents according to the skills of each job incumbent. Line managers expressed difficulty in deciding market pay rates.

All line managers (including two line managers that pointed out market pay is the most important factor as mentioned above) also emphasised individual performance. Furthermore, establishing precise performance is necessary to precisely identify market

pay rates. This is because even though formal job content may be the same or similar, actual job content differs for each job incumbent. This often occurs especially for senior level employees or employees with high skills. Moreover, job content often changes according to changes in business requirements in a quickly changing business environment. Therefore, precise measurement of performance is related to understanding the current job content precisely, and this is related to finding market pay rates more precisely.

With regard to feedback on the pay review, all line managers interviewed answered that they feedback pay review results to their members and the reasons for the results. Company BT2 informs individuals about their pay review results and general pay review situation such as the financial situation of the firm and average pay increases. However, line managers think that only managers can explain why individual pay levels are determined. Therefore, they explain why pay levels were determined to their members individually. The explanation includes their team's average pay increase, ratings of performance reviews and the market pay situation. Also, all non-line managers interviewed answered that they receive feedback about their pay review results from their managers.

Line managers expressed various difficulties relating to pay reviews. One problem is the difficulty in increasing pay levels for high performers within a limited budget. This is because if they recognise some members' high performance and increase their pay levels, other members' pay reviews are influenced. That is, other members' pay increases are restrained or pay levels are even frozen. The pay budget for promotion adjustment is another budget but this budget is also limited. Even though line managers recognise high performance or skill improvement, they cannot promote all of these members within a limited budget. One reason is that Company BT2 paid extra money to high performers or employees with scarce skills for retention purposes until 1999. However, this extra money was cut in 2000. Therefore, there are members whose pay substantially decreased. Line managers consider that this is highly problematic. Another reason is that there was no annual pay review in 2001. This caused dissatisfaction among employees. Line managers said that their members complained about no annual pay review. In fact, all non-line manager interviewees answered that they were not satisfied by the pay review, because there was no annual pay review this year (2001). Another reason is that share options decrease their attractiveness due to decreasing share

prices and a change in the discretionary share options scheme towards decreasing allocations. This also caused dissatisfaction among employees, especially as members granted share options are selected members (line managers decide the members who will be granted share options). Dissatisfaction of these employees is a problem.

Another problem is the difficulty of considering the cost-of-living. Line managers point out that this needs to be considered, in particular for junior members whose pay levels are not sufficient to meet the cost-of-living in London. If they buy a house in London, it costs about £100,000. They have difficulties in meeting the cost-of-living. In fact, there are employees who quit due to financial reasons. However, adjustment for cost-of-living is difficult, because pay costs are limited. If more money is allocated to some members in order to make adjustments for the cost-of-living, other members' pay must be reduced. Furthermore, there are other limitations for a cost-of-living adjustment, such as guidelines for market pay rates. All points where line managers expressed their concerns are related to resource limitations on pay costs. This causes line managers' concerns or difficulties for individual pay determination.

Next is the performance review. All line manager interviewees pointed out the importance of the performance review for pay purposes. One of the reasons for this importance is that the performance review is linked not only to base-pay, but also to other types of financial reward such as the STIP and other incentive schemes for sales persons. Furthermore, the performance review was linked to discretionary share options until 2000. Therefore, the influence of the performance review is great, as it is linked to various reward elements.

The performance review does not only have a judgement purpose, but also many other purposes such as helping members understand the current business situation precisely, delivering organisational objectives to members and sharing information between line managers and their members. Line managers also expressed the view that performance reviews are important for recognition purposes.

The frequency of formal performance reviews varies between the interviewees (line managers and non-line managers). However, formal performance review meetings are set at least twice a year (end of year final review and mid-year review). There are cases where the frequency of formal meetings is more than twice a year, such as formal

meetings set every three months or every month. During the meeting, line managers and members discuss to what extent and how objectives are proceeding, and discussion sometimes includes a change of objectives. Furthermore, all interviewees point out that they communicate their business situation informally on a daily basis. Moreover, when project work finishes, many line manager interviewees set group meetings and/or on a one to one basis in order to review their work and to discuss aspects that need improving. Line manager interviewees emphasised that a frequent review of performance is necessary in a changing business situation, since objectives often change. Even though the theme of objectives does not change, their contents often do. If there are no mid-term performance reviews and line managers suddenly discuss their assessment in an end of year final performance review meeting, members may feel that this is unfair. This decreases motivation and commitment of members to achieve the business objectives and this also generates retention problems of skilled members.

Regarding end of year performance reviews in which ratings in the performance review are decided, the review meeting takes between two and three hours in most cases. Before the meeting line managers have an idea about overall ratings, but they do not finally decide overall ratings until they have finished discussions with their members. There are two types on when line managers decide overall ratings and inform their members: one is during the meeting and the other is after the meeting. In the former, line managers communicate their decision on overall ratings and seek agreement during the meeting. In the latter, line managers discuss opinions on overall ratings with their members, but they finally make their decision after the meeting and inform their members. Some managers incline to either the former or the latter, and some managers vary depending on each situation. According to the line managers interviewed, they agreed about the overall ratings in most cases, although sometimes discrepancies about ratings for each item occur. Non-line manager interviewees said that they always agreed overall ratings.

Most line managers expressed the view that the performance review is a good opportunity to gather information about individual performance from multiple angles, because they gather information from other members of their teams. For example, two line managers gather information on junior members from senior members before the performance review meeting, since they do not closely work with the junior members. They gather information using various methods such as individual conversation,

circulation of opinions among the members and setting up a meeting (face to face meeting and/or telephone meeting). Opinions expressed by senior members about junior members usually differ, because each senior member focuses on or looks at different aspects. Therefore, line managers can gather multiple opinions or multiple information through discussion with various senior members. The line manager interviewees said that the gathering information from various senior members is very effective for many aspects such as pay purposes (judgement for performance and identification of market pay through increased knowledge about their actual job and skill levels), development purposes and task allocation purposes.

Line managers seem very serious about performance management from the interviews, although some line managers expressed concern that performance management is not necessarily managed properly across the organisation. According to them, there are line managers who are poor at performance management. According to employee opinion surveys, performance management in Company BT2 is generally good. For example, 84% answered that 'I understand my own personal objectives' and 7% answered that 'I do not understand my own personal objectives'. HR practitioners said that as line managers understand the importance of the performance review through their own experience in order to improve organisational and personal performance, they are generally serious about performance management.

From the facts gathered from Company BT2, the processes of performance and pay reviews seem to be well managed. At least line managers tend to be serious about these reviews. However, problems may occur because of resource constrain mainly due to Company BT2's financial difficulties.

7.6 Summary

This chapter described payment systems in the UK case firms. Firstly, recent changes in payment systems were discussed from elements of base-pay, as in the Japanese case firms. Although there are no changes in the basic characteristics of the UK type of payment system identified in chapter 3, there are some changes within the same basic characteristics, such as change of job evaluation methods and pay structures. Furthermore, this chapter described how and why these changes occurred using specific situations in each case firm as examples.

Individual pay review processes in the UK case firms were discussed. On the one hand, appraisal is directly linked to pay review in Japanese case firms. On the other hand, performance review is one of the inputs in the performance review in the UK case firms. Accordingly, processes in both pay review and performance were subjects of the discussion in the UK case firms unlike the Japanese case firms. This is one of the main differences between Japanese case firms and the UK case firms.

In the final section, the payment system in Company BT2 was focused upon, and this section discussed characteristics of the payment system and changes to the payment system in more detail. The next chapter will compare characteristics of payment systems between the Japanese case firms and the UK case firms.

Chapter 8: Comparison of payment systems in the case firms between Japan and the UK

8.1 Differences in payment systems between the case study firms in Japan and the UK

As described in the previous two chapters, the payment systems in the Japanese case firms and the UK case firms are rather different. This chapter analyses those differences in the payment systems of the case firms in Japan and the UK.

8.1.1 Differences in elements of base-pay

The first comparison is about elements of base-pay, which are very different between the two countries. Firstly, the thesis compares elements of base-pay in the UK case firms and elements of base-pay in the Japanese case firms before any changes to the payment systems. This is because most Japanese case firms recently changed their elements of base-pay. Before the change, all Japanese case firms used a person-based grade structure as a form of 'qualification grade based on job-related ability' (*shokunou shikaku toukyu*). In this structure, the basis of the qualification grade is job-related ability, not job. Employees are categorised into several qualification grades according to their job-related abilities. Jobs and the qualification grade are loosely related, but jobs are not the determining factor for the qualification grade level. On the other hand, the UK case firms have been continuously using job-based grade structures. Although all UK firms emphasise individual contribution or output performance, and the labour market situation, individual contribution and market rates are determined based on jobs that individuals are assigned. For example, pay increase rates differ according to the assessment of an individual's contribution in their performance review, therefore, individual contribution is accounted for in pay increase rates. However, individual contributions are assessed based on job level or job content. Also, market rates are considered in individual pay determination; however, market pay rates are attached to individual jobs. Accordingly, it is the job that is the basis of the grade structure and the job is the basis of pay.

The UK case firms also continuously consider individual contributions and market pay rates for individual pay determination as explained above. Furthermore, the UK case

firms place more emphasis on output than input performance. Most UK case firms include competencies in their performance review. However, output performance is given more prominence than competencies except Company BF1 and Company BF2. It can be said that the UK case firms focus more on the flow aspect of the person factor than the stock aspect judging by the relative emphasis placed on output and input performance. Hence, elements of base-pay in the UK case firms are job, market and person, and in the person factor, flow aspect is given more focus. These characteristics in the UK case firms are consistent with three basic characteristics -- job-, market- and flow-based payment systems identified in this thesis (chapter 3).

On the other hand, none of the Japanese case firms considered market pay rates in the past. Moreover, as all of the Japanese case firms used the qualification grade based on job-related ability as the basis of their grade structure, the input aspect as job-related ability was the main concern for individual pay determination. Furthermore, many of the Japanese case firms used age-related pay, and age-related pay is one method for focusing on the person input factor. To summarise, the characteristic elements of base-pay in the Japanese case firms are; person-based as a form of qualification grade based on job-related ability, organisation-based with no use of market pay, and stock-based that focuses on the input aspect of the person factor. These characteristics are also consistent with the three basic characteristics identified by this thesis as person-, organisation- and stock-based systems (chapter 3) as in the UK case firms.

However, many Japanese case firms changed the elements of their base-pay and introduced job and market factors. Concerning the job factors, six out of ten of the case firms changed from a person-based to a job-based pay structure for all employees or certain types of employees (mostly managers). Concerning the market factors, five out of ten case firms introduced market pay for jobs for the majority or minority of employees, although market pay has progressed less than the job-based grade structure. Furthermore, all of the case firms used to emphasise the input aspect of the person factor, such as job-related ability and personal characteristics such as age and years of service, all of the case firms have now shifted their focal point to output performance. That is to say, the Japanese case firms have shifted from a stock aspect to a flow aspect as the relative focal point among various types of the person factor.

From the evidence found for elements of base-pay in the Japanese and the UK case

firms, we can say that elements of base-pay were very different in the past and they have become similar due to a shift in the Japanese payment system to a similar directions in the UK payment system, although there are still many differences between the two types of payment systems in terms of elements of base-pay.

8.1.2 Differences in pay structure

The next consideration is pay structure. Pay structure in this case means the pay band structure. Pay band structure has been changing in both the Japanese and the UK case firms. On the Japanese side, all of the case firms used a pay table (*chingin hyou*) in which one pay band (one pay band equates one qualification grade) has a large number of *gou*¹⁰⁵ and the pay level of each employee is indicated by a qualification grade level and *gou* level. In the pay table there is no concept of pay range for one pay band. Although minimum *gou* is fixed as *gou* 1 for each pay band (qualification grade), the maximum *gou* changes each year according to *teiki shoukyu* (regular pay increase)¹⁰⁶. In other words, the maximum *gou* increases, if employees with the maximum *gou* were not promoted to a higher qualification grade. For example, if *gou* 15 is the maximum *gou* for grade 1 in this year and if employees with *gou* 15 in grade 1 were not promoted to grade 2, *gou* 16 (or a higher number of *gou*, since how many *gou* are increased in *teiki shoukyu* in each year is not fixed) becomes the maximum *gou* the following year. As described, in the pay table there is no concept of pay range attached to each pay band. This is different from the 'box type' pay structure popular in the UK.

However, eight out of ten of the case firms abolished this type of pay structure (pay table) for all employees or certain types of employees (mostly managers). Furthermore, seven of the eight firms that abolished the pay table introduced a box type pay structure as is popular in the UK. As a result, the concept of pay range was introduced and pay levels were more rigidly controlled in order that all pay levels were incorporated into the minimum and maximum pay levels set for the corresponding pay band. Therefore, a change of pay structure in the Japanese case firms is seen as a change towards a similar direction as the UK type pay structure.

Yet, pay structure in the UK case firms has been also changing. The change in the UK

¹⁰⁵ *Gou* is the smallest unit of pay level. See section 3.3.4 in chapter 3 or Appendix IV about *gou*.

¹⁰⁶ See section 3.3.5 in chapter 3 or Appendix IV about *teiki shoukyu*.

case firms is towards a broadly and loosely banded pay structure. As a result, pay levels are less rigidly controlled by pay bands than before the change. In the past, each pay band had a pay range with minimum and maximum pay levels and all pay levels were incorporated into a corresponding pay band as much as possible, although all pay levels corresponding to a pay band are not necessarily within the pay band. But after the change, the case firms do not try to enter all pay levels into a corresponding pay band, as pay bands are indicated as lower, mid and upper quartile, not minimum, mid and maximum.

The change of pay band structures in the UK case firms is seen as being in the opposite direction to change in the Japanese case firms. In the UK, pay ranges have become wider and/or looser. In Japan, pay ranges have been fixed and narrower due to the change towards a 'box type' pay structure. In other words, pay levels are controlled more tightly according to grades or pay bands. The UK and Japanese sides share the same reasons for their changes -- strengthening the link between pay and individual contributions. However the changes are in opposite directions. Another reason for change of pay structure in Japanese case firms towards decreasing seniority-related pay may be a cause of the difference. In the Japanese case firms, setting a maximum pay point using narrowing pay ranges can reduce seniority-related pay increases. In the UK case firms, it is assumed that as seniority-related pay is small, they do not have to strongly consider a reduction of seniority elements within the design of the pay structure.

The author asked whether seniority elements were related to pay in the UK case firms. Company BT1 and Company BO1 answered that seniority elements can be related to pay. The other six firms said that seniority is not related to pay. Company BO1 answered that the firm's management style was paternalistic, and therefore number of years of service tended to be long and long service can be related to pay level¹⁰⁷. Company BT1 has rapidly grown over the past twenty years. Staff who joined the firm in the early period tend to feel high loyalty, which can be rewarded by high pay levels. Although there is no clear relationship between years of service and pay levels, seniority

¹⁰⁷ The paternalistic form of management has recently been changing in Company BO1. In addition, Company BO1 was taken over just before the research (the takeover was in July 2000 and the research took place from July to August 2000). The new parent firm does not have a paternalistic form of management. Company BO1 would be likely to have further changed its management style through the acquisition.

can be one of the reasons why long serving employees tend to have high pay levels. These answers indicate that seniority-related pay should be lower in the UK case firms than in the Japanese ones, since seniority-related pay in the Japanese case firms is a formal system. The UK case firms do not have formal system associated with seniority-related pay.

Further to this, internal documents provided by Company BT1, Company BT2 and Company BO1 about pay review policies¹⁰⁸ indicate similar statement like “employees working in the same jobs for the long term often have low promotion opportunities, their pay increase should also be low in these cases” (internal document in Company BT1 is used as an example). These documents show that many years of service in the same job can result in low pay increases or a pay freeze. Seniority-related pay should be lower in these situations than in the Japanese case firms where pay levels usually increase according to years of service, regardless of changes in job content. Hence, it is considered that a degree of seniority-related pay is the main cause of the opposite directions of the changes between the case firms in the UK and Japan.

8.1.3 Differences in performance review and pay review

The third consideration is the pay review process. Two issues in the pay review process are discussed here; the difference between performance review and *jinji kouka* (appraisal)¹⁰⁹, and the differences in the pay review process between Japan and the UK. Whilst the performance review and appraisal constitute one process within the total pay review process, performance review and appraisal are discussed independently from other aspects of the pay review process. In other words, performance review and appraisal are given the same priority in the pay review process. The main reason for this is that in the Japanese situation the result of the appraisal is directly linked to the pay review result (appraisal-related pay increase/decrease rates), therefore, the appraisal is only one critical factor in the Japanese case firms. Furthermore, although the result of the performance review is one of the inputs of the pay review in the UK case firms, the result of the performance review is still very important in terms of the pay review. Therefore, the author considers that it is worthwhile discussing the performance review independently for the UK case firms as well.

¹⁰⁸ The documents concern guidelines for pay reviews for line managers.

¹⁰⁹ *Jinji kouka* is expressed as ‘appraisal’ as discussed in section 3.3.6 in chapter 3. See section 3.3. 6 in chapter 3 or Appendix IV about meaning of *jinji kouka*.

(1) Differences between performance review and *jinji kouka*

There are many differences between performance reviews in the UK case firms and *jinji kouka* (appraisals) in the Japanese case firms. The main differences are summarised.

The first is relative ownership for the decision in performance reviews (UK case firms) and the appraisal (Japanese case firms). Line managers may have more decision making power in performance reviews on the UK side than they do on the Japanese side. The main reason is the difference in coordination function executed by HR function. In the Japanese case firms, the HR exercises a strong coordination. On the contrary, in the UK, no line manager interviewees said that their ratings had been changed by the HR function. This contrast indicates difference of relative ownership for decision in performance review in the UK case firms and appraisal in Japanese case firms.

The second is the purpose of the performance review and the appraisal. The performance review is only one assessment tool operating within line relationships and is more comprehensive including development and judgement purposes. On the Japanese side, various evaluation (*jinji hyouka*)¹¹⁰ tools operate within line relationships (except Company JT3 which is a UK subsidiary). One of the reasons for this difference may be that the judgement function is too strong to combine with the development purpose in the Japanese case firms, where ratings are directly linked to pay and promotion. The UK case firms expressed a difficulty in combining the two purposes in one performance review. However, the judgement function of the performance review in the UK case firms may be weaker than the appraisal function in the Japanese case firms.

Furthermore, the type of appraisal (*jinji kouka*) which deals with the judgement purpose is divided by purpose such as grade review and pay review. Each appraisal on the Japanese side has a specific purpose. The author assumes that the main reason for this specificity of each appraisal is centralised decision making for HR issues including individual pay determination in the Japanese case firms. Regarding individual pay review, in the Japanese case firms, corporate HR conducts individual pay review. Line

¹¹⁰ Meaning of *jinji hyouka* is indicated in section 3.3.6 in chapter 3 and Appendix IV. *Jinji hyouka* is expressed as evaluation to distinguish from *jinji kouka* as discussed in section 3.3.6 in chapter 3.

managers are not directly involved in the decision of individual pay review, although they are indirectly involved through decisions of appraisals. HR function has no direct knowledge on individual contribution. Therefore, making specific relationship between each type of appraisal and each pay purpose is desirable in order to specify or trace back reason in documents for the decision of each purpose. However, in the UK case firms, line managers who have direct knowledge of individual contribution decide individual pay increase. Therefore, there are little needs to specify or trace back reason in documents. Thus, there is little need to divide appraisal for each purpose in this case.

The third is forced distribution on ratings. Most case firms in Japan operate forced distribution, but none in the UK do. Whether forced distribution is operated may be one of the reasons for the difference in the coordination function exercised by the HR function for ratings. As forced distribution is operated on the Japanese side, the coordination of the ratings by the HR function is more important. Reasons for the difference will be discussed in 'pay review' and 'grade promotion' sections.

The fourth is the degree of disclosure and agreement. The UK side may have a higher level of disclosure and agreement than the Japanese side. As indicated earlier, reviewees are required to sign their performance review forms in the UK case study firms, but there are no such requirements in Japan. Although the disclosure level recently increased in the Japanese case firms, it is still lower than that in the UK. Regarding agreement, both HR and employee interviewees are less likely to consider agreement on ratings on the Japanese side. This is also a difference.

The fifth is the degree of seriousness. UK reviewers and reviewees tend to spend longer on the preparation and practice of performance review meetings than Japanese appraisers and appraisees. Through this difference, the UK side seems to be more serious about performance reviews than the Japanese side. Line managers interviewed in Japan are serious about the contribution levels of their members, but this seriousness is not strongly linked to the appraisals. The reasons for this difference include strong ownership by line managers for performance reviews and a higher degree of disclosure in the UK case firms than the Japanese ones. However, caution is needed for comparison between the two countries. This is because Japanese case firms operate evaluation tools (*jinji hyouka*) with development purpose separating from appraisal (*jinji kouka*) with judgement purpose, therefore, we should not simply compare time

used for appraisal (*jinji kouka*) in Japanese side and performance review in the UK side in order to judge degree of seriousness between the two countries.

(2) Differences of pay review

There are many differences in the individual pay review between the case firms in the UK and Japan. The major differences are discussed here. The first is the pay review process where the performance review is one of the inputs of the pay review, therefore results of the performance review are indirectly linked to pay reviews in the UK case firms. Ratings in appraisals are directly linked to pay increase/decrease rates in the Japanese case firms. The UK firms emphasise the performance review as the important factor for decisions in pay reviews and they set guidelines on pay increase rates according to rating categories. For instance, Company BT1 sets a guideline pay increase rate of 0-4% for 'Development/Improvement', 5-7% for 'Meets Expectation' and 8-10% for 'Exceeds Expectations'. However, line managers also consider other factors as described above. Hence, they do not necessarily follow the guidelines.

The main reason for this difference may be the use or non-use of market pay rates in pay reviews. Judgement in performance reviews is an internal judgement of the value of employees. Market pay is the external value of employees expressed as market rates for assigned jobs. The UK case firms consider both the external and internal value of employees, therefore, the result of the performance review is one of the inputs for the pay review. The Japanese case firms do not consider the external value of employees, therefore, the internal judgement of the appraisal is sufficient for pay reviews.

These differences in the pay review process may be one of the causes of the differences between performance reviews and appraisals as no UK case firms use forced distribution. As a result, most employees are categorised in the mid rating categories as described in the 'performance review' section. In contrast, the majority of Japanese case firms use forced distribution as described in section 6.4.2 in chapter 6 using the case of Company BT1. In Company BT1, the distribution rate for each rating category is S=5%, A=20%, B=+25%, B=35%, C=15% and D=hardly rated (S is the highest and D the lowest rating category). The main reason for the use of forced distribution by Japanese case firms is considered as follows.

In the Japanese firms, ratings in appraisals determine appraisal-related pay increase/decrease rates. Thus, forced distribution makes it easy to control the pay cost allocation of the total pay budget for individuals. As ratings in the performance reviews in the UK case firms are not directly linked to pay increase rates, there is no strong need for forced distribution to control pay cost allocation for individuals. In the Japanese case firms that do not use forced distribution, the appraisal-related pay increase/decrease rate for each rating category is decided after the final decision on ratings is made.

The second difference is the degree of correlation between contribution levels and pay levels. Chapter 6 described the contribution levels, and pay levels are sometimes divergent in the Japanese case firms. However, such divergence was not found in the UK case firms. Here, objectives are set based on job accountabilities or task contents. Pay levels are attached to jobs and output performance is assessed based on the objectives. There is no strong divergence between contribution and pay levels. Therefore, the main reason for the difference is considered to be person- and job-based systems. In fact, Japanese firms with the job grade system do not have a large divergence between contribution levels and pay levels unlike those with the person-based system as discussed in chapter 6.

Other characteristics identified by this thesis (chapter 3) in the Japanese and UK payment systems are also reasons. On Japanese side, under the person-based system, grade promotion occurs by the sum of rating points and pay levels are based on the grade levels. Therefore, pay levels are determined based on assessment in the long term, and are not necessarily in accordance with current contribution levels. Furthermore, an organisation-based system does not consider market pay rates with a higher objectivity than pay decisions made only by internal judgement. These things cause divergence between the current value of employees and their pay levels. Therefore, three characteristics of the Japanese payment system cause a low correlation between the current value or contribution of employees and their pay levels.

In contrast, the flow-based system combined with job- and market-based systems used in the UK case firms determines pay levels based on assessment of current value or contribution of employees. Therefore, the UK case firms with this system tend to have consistency between pay levels and current value or contribution of employees than the Japanese case firms which have the person-, stock-, and organisation-based payment

system.

Another reason is that of pay increases as promotion adjustment, although it is not a major reason. In the UK case firms, pay levels are normally increased just after job promotion, between pay bands and within a pay band. On the other hand, the annual pay review is the only opportunity for a pay review in a year in the Japanese case firms. This practice in the Japanese case firms can reduce the correlation between current contribution levels and pay levels.

The third difference is ownership of the pay reviews. On the UK side, line managers conduct the pay reviews. On the Japanese side, corporate HR does them. Although line managers are involved through decisions during appraisals, this is indirect rather than direct. The reasons for this difference will be discussed in the next chapter.

8.1.4 Difference in relationships between performance reviews and promotions, and *jinji kouka* and promotions

The types of link between performance reviews and promotions in the UK case firms which have a job grade system differ from the Japanese case firms which have a person grade system. In these Japanese firms, ratings are directly linked to grade promotion as described in section 6.4.4 in chapter 6 using an example of Company JO1. However, no case firms in the UK directly link ratings with promotions, although they do assess promotion opportunities within performance reviews. For example, Company BF2 assesses using the following six categories.

- A – Two organisational levels in 5 years
- B – One organisational level in 5 years
- C – Move within same organisational level
- D— Correct level/correct job
- E – Wrong level / wrong job
- X – Too early to tell

Furthermore, line managers fill in suggested job titles on performance review sheets. However, the suggestion on career development potential does not directly determine promotions. This practice is different from the Japanese case firms which have the person grade system. Decisions on promotions in the UK case firms are separate from

decisions within performance reviews. The same practices are applied in the Japanese case firms which have the job grade system. For example, in Company JR1 with job grade system, line managers assess promotion opportunities within one of the appraisal tools. However, the assessment of promotion opportunities does not directly determine promotions.

The type of link between ratings and promotion, whether direct or indirect, may cause other differences between the case firms in the UK and Japan. Firstly, the UK case firms tend to regard promotion purpose as a development purpose whilst the Japanese case firms tend to regard promotion purpose as a judgement purpose. If results of appraisals directly link to grade promotions, the appraisals judge grade promotions. If results of performance reviews do not directly link to grade promotions, promotions can be facilitated through performance reviews. Therefore, the promotion purpose tends to be a judgement purpose in the former case and a development purpose in the latter.

Secondly, a direct link between rating and promotions may be one of the reasons why many of the case firms in Japan use forced distribution in ratings. Control of distribution for ratings is needed in order to control the number of grade promotions. In theory, there is no limitation on the number of grade promotions in the person grade system, as discussed in chapter 3. However, the firms need to control the number of grade promotions in practice in order to maintain employee composition in a hierarchical order.

8.1.5 Differences in treatment for low contributors

None of the case firms in the UK have a pay decrease system. The lowest result of a pay review is 0% increase. If employees consecutively get low ratings, they are subject to dismissal rather than a pay decrease, although there are no strict guidelines about levels and durations of low ratings in terms of conditions for dismissal. For instance, Company BF1 and Company BF2 have general guidelines that if employees get low ratings in both output performance and competency on two consecutive occasions they can be dismissed, but the guideline is not always applied to all cases. Alternatively, as the UK case firms generally make a redundancy pool to deal with redundancy, they select employees for this relating to ratings. In addition, how to deal with low contribution differs by employee levels. Generally, low contribution by senior employees is dealt

with more strictly.

The policy of the UK case firms is that low contributions are dealt with by dismissal rather than by a decrease in pay. The reasons for this policy were obtained from the UK case firms. The main reason is the UK regulation about pay decrease. If pay is decreased due to individual low contribution, organisations must show evidence of this low contribution, and individuals whose pay levels are decreased must accept the pay decrease. If job levels are decreased due to individual low contribution and pay decreases are associated with job demotions, individuals whose pay is decreased also must accept. The UK regulation requires these conditions are satisfied in order to decrease pay. When pay decreases happen due to organisational reasons, firms must ask employees whether they will accept them. If the majority of employees agree with the pay decreases, firms can go ahead. Moreover, firms must agree with the individuals who are subject to pay decreases. However, if firms ask employees to accept a decrease in pay, those with high career opportunities are more likely to leave, and employees with low career opportunities are more likely to stay. This is the worst scenario for the case firms. Therefore, they choose dismissal rather than pay decreases.

In contrast to the UK case firms, seven Japanese case firms implemented a base-pay decrease system and/or grade demotion system associated with pay decreases. For these firms, pay decreases and/or grade demotions are easier options than dismissal under the current judicial and social situation in Japan. Moreover, the Japanese case firms are concerned that dismissal can break psychological contract of employees, because the Japanese case firms have maintained a long term employment policy. Generally, the Japanese case firms deal with low contribution by pay decreases. All of the firms implement *kibou taishoku* (voluntary turnover) programmes¹¹¹. Pay decrease is the message for low contribution levels and employees who have received this message are encouraged to apply for the voluntary turnover programme. But how to deal with low contributions is largely different between the Japanese case firms.

The problem with this approach is that the Japanese firms cannot prevent valuable employees applying for voluntary turnover. The case firms must accept all applications. In fact, some HR interviewees said that their firms had accepted applications from

¹¹¹ Content of *kibou taishoku* is substantially same as voluntary redundancy. But as word '*yojyou jinin*' (redundancy) is not socially correct in Japan, word '*taishoku*' (turnover) is used in Japanese firms as indicated in chapter 6.

employees with top contribution levels. The case firms in the UK often reserve the right to reject applications for voluntary redundancy, if highly valuable employees have applied. As indicated, the different legal and social situation and the different employment policy of the firms distinguish how the case firms deal with low contribution in the two countries.

A different opinion about pay decrease or dismissal was expressed by Japanese interviewees in Company JT3 (subsidiary of the UK case firm). Company JT3 cannot decrease pay levels for employees whose role levels were assessed as lower than their pay levels during the introduction of the role grade system, whilst pay levels of employees whose role levels were assessed as higher soon increased. As a result, the total pay cost increased. The reason for not decreasing pay is that senior managers dispatched by the UK parent firm did not accept a pay decrease. The senior managers claimed that pay decreases do not normally happen, and they have not heard of pay decreases. The Japanese interviewees expressed that these senior managers do not understand Japanese HRM practices that dismissal is difficult and that pay costs are usually adjusted by increasing or decreasing individual pay levels.

8.2 Two types of payment system bundles

As discussed above, there are many differences between the payment systems in the Japanese and the UK case firms. The author considered three differences as being particularly significant. The first difference concerns the time span to establish of a sense of equity, the second is concerned with the decision making structure regarding individual pay determination and the third is type of psychological contract for pay. Why the author considers these three issues to be significant among the many differences will be discussed as part of each issue.

The author firstly recognised the first differences when the author found correlations between individual pay levels and individual contribution levels are lower in the Japanese firms than in the UK ones as mentioned in chapters 6 and 7, and section 8.1.2 in this chapter. As the correlation between current contribution levels and pay levels tends to be lower in the Japanese case firms, it is assumed that the motivation of employees in the Japanese case firms would tend to be low, if the assumption of equity theory is applied. However, the research could not find any evidence of low motivation

from the interviewees in the Japanese case firms. Therefore, the question needs to be asked as to why the interviewees in the Japanese case firms were not demotivated, despite the low correlation between contribution (input) and pay levels (reward). This research found that the time span for establishing a sense of equity in the Japanese case firms differs from the concept of equity presented by the equity theory (or other studies relating to a sense of equity or sense of fairness). That is, the interviewees in the Japanese case firms tend to have a longer time span for establishment of sense of equity.

The interviewees in the Japanese case firms seemed not to be keen to achieve correlation between contribution levels and pay levels at each occasion of pay determination. They seemed to think that even though high correlation is not achieved in the short term, it will be realised in the long term, as discussed in section 6.5.4 in chapter 6. The author used the example of Company JF1 in section 6.5.4 in chapter 6. Male university graduate employees who have high promotional opportunities usually engage in managerial jobs before promotion to a managerial grade. This means that pay levels of these employees before promotion to managerial grade are lower than their contribution levels. This is a normal situation in Company JF1 because they are compensated after promotion to managerial grade by high pay levels in the long term. This example illustrates that a sense of equity is more likely to be achieved in the long term, even though in the short term it is not necessarily high. Similar situations were also found in the other Japanese case firms. Expressed in another way, a sense of equity in the long term seems to be a taken-for-granted issue for the interviewees in Japanese case firms.

Reasons for this long term sense of equity can also be analysed from the three basic characteristics of the Japanese payment system identified by this thesis (chapter 3). One of the reasons that contribution levels and pay levels in the long term may be more strongly correlated is the use of a stock-based payment system. The stock-based payment system contributes to the sense of equity in the long term at the expense of the sense of equity on each occasion of pay determination. The person- and organisation-based payment systems can stabilise pay levels more than the job- and market-based systems¹¹². The characteristic of stable pay levels is suited to a payment

¹¹² Although the person- and organisation-based payment system can stabilise pay levels in theory as discussed in section 3.4.1 in chapter 3, in practice in the case firms, pay levels in the Japanese case firms fluctuate more than those in the UK case firms. The main reason for this is that the Japanese case firms put more emphasis on job security than the UK case firms as

system that can increase the long term sense of equity. Therefore, the Japanese type of person-, stock- and organisation-based system is suitable as the system that can achieve a higher long term sense of equity. Needless to say, the establishment of a long term sense of equity presupposes the organisation-based employment system.

On the other hand, the correlation between current values or contribution levels and pay levels tends to be high in the UK case firms. The UK payment system is characterised by the job-, flow- and market-based payment systems and is suitable for determining pay levels according to the current value or contribution of employees. Therefore, the payment system can increase the sense of equity on each occasion of pay determination. Furthermore, the UK payment system that can increase this sense of equity supports the market-based employment system. If this sense of equity is low, firms may have difficulty in retaining employees, especially those with a high market value under the market-based employment system. The establishment of the sense of equity on each occasion of pay determination is a condition of retention under the market-based employment system.

As shown, the difference on time span for establishment of the sense of equity can be explained by the three basic characteristics identified by this thesis. Thus, this difference on time span for establishment of the sense of equity is consequence of the three basic characteristics of inherent in each type of payment system.

There are mainly two reasons why the author considers that this difference in time span to reach a sense of equity is particularly significant among the many differences found through the case studies. One is that a sense of equity in the long term supports the Japanese type of payment system such as person-, organisation- and stock-based systems. As pointed out in section 3.4.1 in chapter 3, these three characteristics have problems as assessment for individual contribution tends to be subjective and less consistent under person- and organisation-based systems, and pay levels tend to be

discussed in section 8.1.4 in this chapter. There are two main methods for adjustment of pay cost against financial situation. One is adjustment by head count and the other is adjustment by pay levels of individual employees. If firms put high priority to job security, the firms use adjustment of pay cost through adjustment by pay levels of individual employees (Koike 1994, 1999, Nagano 1996). This is the case of the Japanese case firms. They put higher priority to job security, therefore, they adjust pay cost by fluctuation of individual pay levels. On the other hand, the UK case firms can adjust pay cost through adjustment by head count more easily as discussed in section 8.1.4 in this chapter.

divergent from the current contribution levels under stock-based systems. However, emphasis on a sense of equity in the long term compensates for these problems. Therefore, the Japanese type of payment system is effective due to this emphasis on a sense of equity in the long term.

The other reason is the theoretical aspect. There are massive studies on the sense of equity or sense of fairness (Adams 1965, Folger and Cropanzano 1998, Folger and Konovsky 1989, Brockner and Wisefeld 1996, Vecchio 1981, Scholl et al. 1987). However, these studies tend to focus on a sense of equity in each occasion of HRM decision and seek conditions to improve the sense of equity in each occasion of HRM decision. For example, studies on distributive justice, procedural justice and relational justice tend to seek conditions to increase a sense of equity or fairness from perspective for each occasion of HRM decision. Relational justice refers to “the quality of the interpersonal treatment received by an individual” (Folger and Cropanzano 1998:xxip) and definitions of distributed justice and procedural justice were mentioned in section 2.4 in chapter 2. Yet, this research revealed that there is another approach for improving the sense of equity. That is, different time spans create different ways of establishing a sense of equity. The author considers this is theoretically significant.

The second significant difference concerns the difference in the decision making structure for individual pay determination. In the Japanese case firms, corporate HR conducts pay reviews, whereas in the UK case firms, it is the line managers. In the Japanese case firms, line managers are not directly involved in individual pay reviews, although they are indirectly involved through decisions made during appraisals. Corporate HR decides individual pay increase/decrease rates for appraisal-related pay increases (*satei shoukyu*) according to individuals' ratings categories as described in chapters 6.

For the interviewees (both HR practitioners and other employees) in the Japanese case firms, the pay review by corporate HR was seen to be a taken-for-granted issue. They could not imagine other types of pay review. For example, when the author said that one difference between Japan and the UK is that line managers in the UK, and not HR, decide their members' pay levels, one HR interviewee in the Japanese case firm firstly claimed that line managers decide pay increase/decrease rates in his firm because line managers decide ratings in appraisals. The author explained that line managers in

Japanese firms are involved in pay decisions through decisions for appraisals ratings, but this is indirect. Line managers do not directly decide pay increase/decrease rates for their members. In the UK case firms, line managers decide each member's pay increase/decrease rate within the budget. The interviewee did not understand the difference at the time. When the author met him next time, he said 'I finally understand your point of the decision maker of individual pay levels being different between Japan and the UK. However, I cannot imagine that a line manager can decide pay levels properly'.

Furthermore, HR function (at both corporate and divisional levels) in the Japanese case firms has stronger coordination powers for appraisals than those in the UK case firms. However, Japanese interviewees did not think the coordination power of HR was strong. The strong power seems to be a normal or taken-for-granted issue for the interviewees in Japan as discussed in section 6.6.5 in chapter 6.

In the UK case firms, line managers conduct pay reviews of their staff. Although the HR function sets the guidelines for pay increase rates in relation to such as pay bands or employee levels and rating categories in performance reviews, line managers do not necessarily follow them as indicated in chapter 7. Pay increase rates are decided through the comprehensive judgment of line managers who consider many factors that indicate the value that an individual has for the firm. In addition, the HR function does not exercise strong coordination powers in terms of decisions during performance reviews.

Different types of individual pay review were discussed by HR practitioners in one of the UK case firms that took over a Japanese firm in 1999. These HR practitioners knew the difference between the individual pay review in the UK and Japan. They explained that in the UK situation, as HR intervened in individual pay reviews in the past more than now, the pay review was then more centralised than now. But even though the pay review was more centralised in the past, the degree of centralisation was not as high as the Japanese firms. They perceived the Japanese individual pay review as being too centralised and this decreased flexibility for individual pay reviews. Now the Japanese subsidiary is changing its decision making structure to being a more decentralised one. Nonetheless, individual pay reviews in the Japanese subsidiary are much more centralised than in the UK parent firm. The UK parent firm thinks that as pay determination should be adapted to the local situation, individual pay reviews in the

Japanese subsidiary do not need to follow the same system as in the UK parent firm.

The author found that this difference in the decision making structure between the two countries through case study evidence was the same as the difference in the time span to establish a sense of equity, and that this difference is also explained by the basic three characteristics of Japanese and UK payment systems as follows.

If line managers judge individual pay levels, personal preferences or interests tend to be included in the judgments, and levels of judgment differ between line managers (some are harsher whilst others are more lenient). As a result, pay reviews may lose consistency across the organisation. Problems such as low objectivity and low consistency in pay reviews deteriorate under the person- and organisation-based payment systems. This is because the person- and organisation-based payment systems do not have standards with relatively high objectivity, such as job content and market pay. If the HR function (with little personal interest in individual employees) has the decision making power for individual pay determination, the problems of judgment by line managers can be relaxed (Yashiro 2002).

The UK case firms also have problems with judgment by line managers, but these can be mitigated by the job- and market-based payment systems, because they have standards with relatively high objectivity such as job content and market pay. Furthermore, job hopping often occurs in the UK case firms under the market-based employment system. If judgments by line managers are highly subjective and inconsistent, employees can change their jobs. This high job-hopping rate can reduce subjective and inconsistent judgments (Yashiro 2002). In fact, line manager interviewees in the UK case firms have experience of losing their own staff. As a result, their main concern during pay reviews is often staff retention.

Hence, the UK type of payment and employment system can solve the problem of line manager judgments to some degree. The conduct of pay reviews by line managers is a suitable method within these systems, because line managers know the skill, knowledge and output performance of their staff more precisely than the HR function. Consequently, the sense of equity can be increased by pay reviews conducted by line managers more than by those conducted by the HR function.

As indicated above, the difference on decision making structure about individual pay determination is explained by the three basic characteristics as same as the difference on time span for establishment of the sense of equity. Therefore, this difference on decision making structure about individual pay determination is also consequence of the basic characteristics of each type of payment system.

There are mainly two reasons why the author considers that this difference in the decision making structure is significant. One is the same reason as the sense of equity in the long term. That is to say, centralised decision making supports the Japanese payment system of person-, organisation-, and stock-based system in the same way as a sense of equity in the long term. The Japanese payment system has problems, as assessment derived from a person- and organisation-based system tends to be subjective and inconsistent, and current contribution levels and pay levels derived from a stock-based system tend to be divergent as discussed in section 3.4.1 in chapter 3. A centralised decision making structure supplements these weaknesses to increase stability for assessment for contribution levels and pay levels by the intervention or decision of HR. Even though the assessment of individual contributions is changed by line managers, HR intervenes in the assessment. This makes the assessment more stable as pointed out in section 3.4.1 in chapter 3. Furthermore, as corporate HR decides individual pay levels, criteria used by the corporate HR do not change often or radically. As indicated, a centralised decision making compensates weaknesses inherent in the Japanese payment system.

The other reason is that this difference causes other differences between Japan and the UK. For example, firstly, the purposes of the performance review and *jinji kouka* are different. The performance review has both development and judgement purposes because the performance review is only one assessment tool operating in the line relationship in the UK, but *jinji kouka* only includes a judgement purpose because other types of assessment tools focusing on the development purpose operate in the line relationship in Japan. Furthermore, type of *jinji kouka* is also separated to each purpose. Secondly, the degree of disclosure, agreement and seriousness of the performance review in the UK is higher than for *jinji kouka* in Japan. The cause of these differences is the difference in the degree of centralisation between the UK and Japan. Regarding the first point, the decision and the reason for the decision for each purpose should be specifically indicated in order to clarify the decision and reason for each purpose, if HR,

which does not have direct knowledge of individual contributions, decides pay levels. In contrast, there is no such need, if line managers, who have direct knowledge of individual contributions, decide the pay levels. One assessment tool including many purposes is more efficient in this case. As far as the second point is concerned, disclosure and agreement about ratings between line managers and employees may be not very important, if ratings can be changed by HR. Furthermore, if ratings can be changed by HR, line managers and employees may not take appraisals very seriously. This is the case of Japanese case firms.

In addition, the characteristics in the two types of payment system influence the employee perspective of their pay (this thesis calls this the 'psychological contract of employees for pay'). In the Japanese case firms, the psychological contract is considered as 'pay for age'. For example, the author asked 'do you know the pay levels for employees with similar jobs to yours in other firms in the same industrial sector?', to which some interviewees answered 'yes, I know, because large firms in this industrial sector have almost the same pay levels for the same age groups'. Other interviewees answered 'I have heard that pay levels in company K are higher than ours' (based on a comparison between the same age groups -- not between the same job groups).

In contrast, in the UK case firms the psychological contract is 'pay for job and contribution'. For example, line manager interviewees pointed out that decisions on precise market pay and the establishment of pay according to individual contributions (especially output performance) are the most important criteria for pay reviews in order to retain their staff. They pointed out these criteria based on their experience of losing staff. Non-line manager interviewees used external relativity of their pay levels as a criterion of their retention.

Both types of psychological contract can also be explained by the three basic characteristics identified by the thesis (Chapter 3). In the Japanese case, a psychological contract is formed by seniority-related pay as age-related pay. Age is the input aspect of the person factor. Therefore, person-based and stock-based payment systems form this type of psychological contract. Regarding an organisation-based payment system, if market pay is used in pay determinations, as the labour market situation changes according to the relationship of labour demand and supply, as market economics suggest, it is difficult to establish 'pay for age'. Therefore, an organisation-based payment

system that does not directly consider market pay for individual pay determination is more related to 'pay for age' than a market-based payment system. In the UK case, all three characteristics of job, market and flow contribute to 'pay for job and contribution'. This is because the job is the basis indicating current contribution level and market pay indicates current market value for the job, and a flow-based system focuses on the current employee's value or contribution rather than on their long term contribution.

As described, difference on type of psychological contract between Japanese and the UK case firms is also explained by the three basic characteristics. Therefore, two types of psychological contract for pay is consequence of the three basic characteristics as same as difference on time span for establishment of the sense of equity and difference on decision making structure about individual pay determination.

The reason for the author considering psychological contracts as being significant is that a psychological contract as 'pay for age' compensates for the weaknesses inherent in the Japanese payment system as assessment tends to be subjective and inconsistent, and pay levels tend to be divergent from the current contribution in the same way as the long term sense of equity and centralised decision making.

Furthermore, the three significant differences as a consequence of the three basic characteristics fit together. Centralised decision making contributes to the achievement of a long term sense of equity and the psychological contract of 'pay for age' through HR's intervention in assessments and HR's direct decision for pay levels. If line managers decide assessment with little intervention from HR and line managers decides individual pay levels, the establishment of a long term sense of equity and psychological contract as 'pay for age' may be more difficult. Decentralised decision making contributes to the achievement of a sense of equity for each occasion and to the psychological contract of 'pay for job and contribution' through the judgement of line managers who are more aware of individual jobs and contributions than HR.

A long term sense of equity increases the effectiveness of centralised decision making, because judgement by HR tends to be more stable than that by individual line managers. Alternatively, centralised decision making loses its effectiveness if a sense of equity for each occasion is emphasised, because HR does not have direct knowledge about individual contribution. This, in turn, applied to a sense of equity for the long term

supports centralised decision making and a sense of equity for each occasion supports decentralised decision making. A long term sense of equity serves as the basis of a psychological contract of 'pay for age' and vice versa. Also, a sense of equity for each occasion of pay determination serves as the basis of a psychological contract of 'pay for job and contribution' and vice versa.

Further, the three significant distinctions as emphasis on sense of equity in the long-term, centralised decision making for individual pay determination and psychological contract as 'pay for age' in the Japanese case firms, and as emphasis on sense of equity in each occasion of pay determination, decentralised decision making for individual pay determination and psychological contract as 'pay for job and contribution' in the UK case firms fit for each type of employment system as organisation-based employment system and market-based employment system.

Figures 8-1 and 8-2 express the type of bundles in the Japanese and UK payment systems, and their relationships with the employment systems.

Figure 8-1: Japanese type of payment system as a bundle and its relationship with the employment system

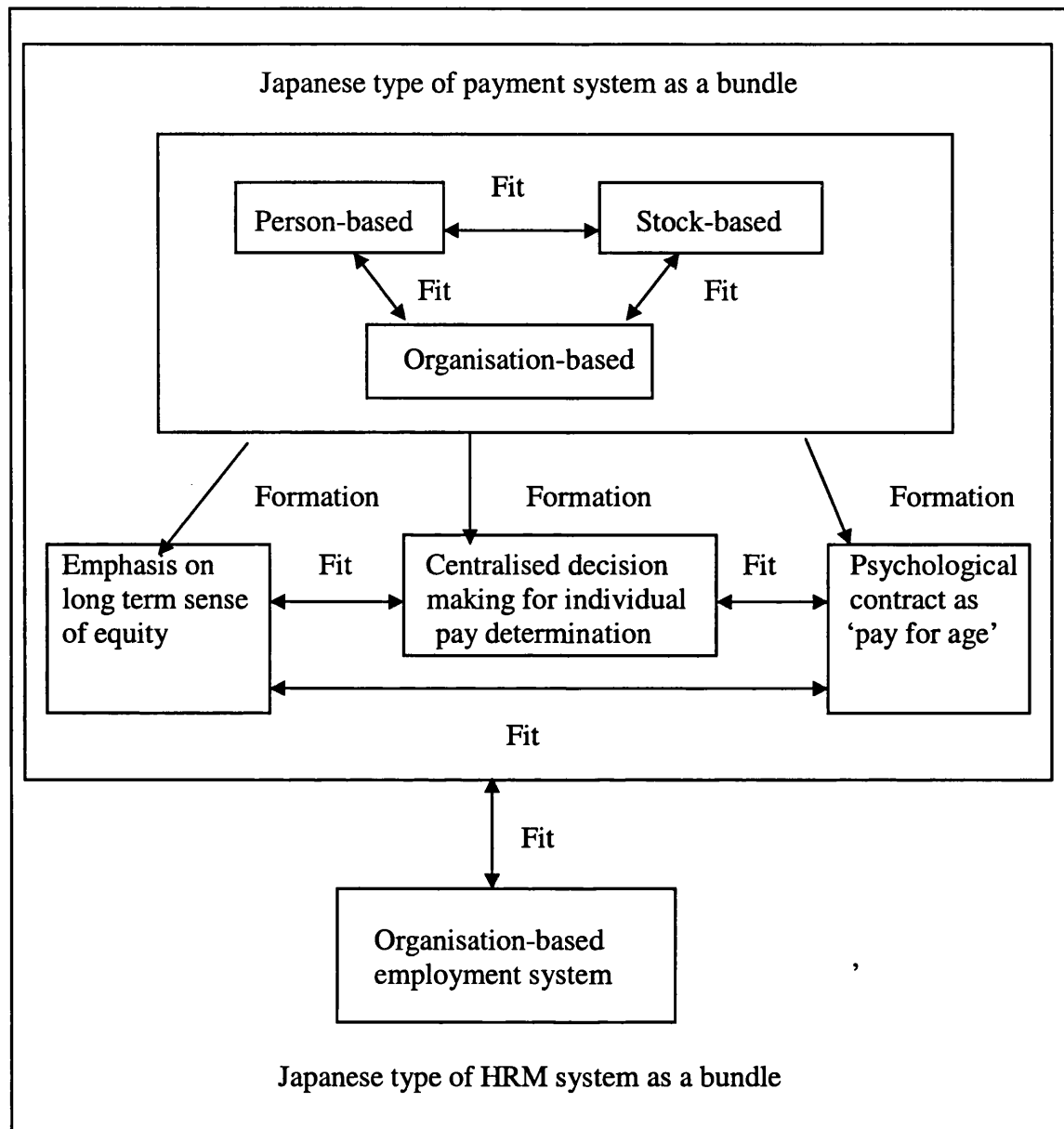
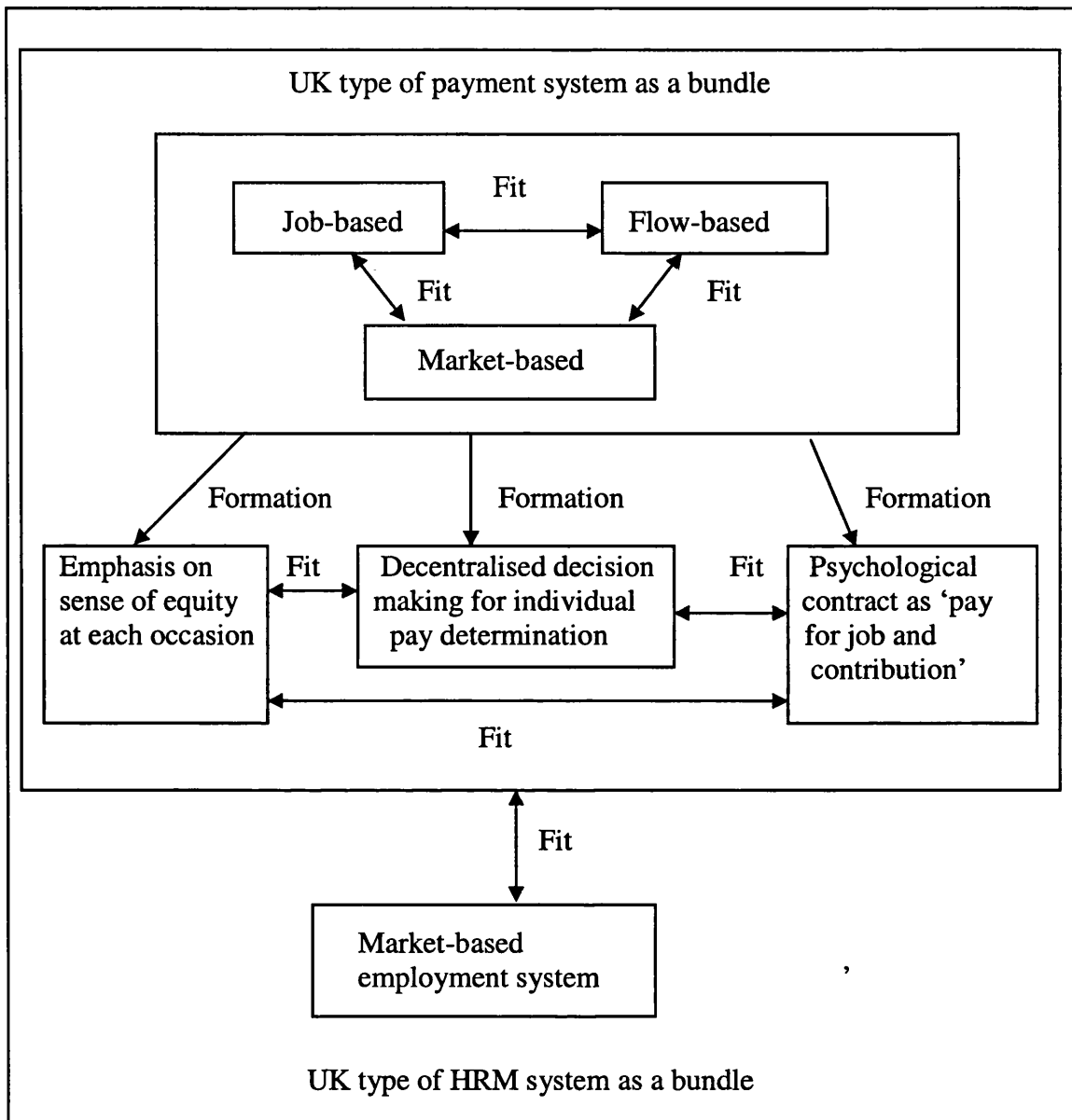


Figure 8-2: UK type of payment system as a bundle and its relationship with the employment system



8.3. Change of payment systems in case study firms in Japan

8.3.1 Differences in case study firms from traditional Japanese payment system

This thesis has identified the three characteristics of Japanese payment systems as person-, stock- and organisation-based systems. However, all of the Japanese case firms have been changing some aspects of their payment systems. As a result, the all three characteristics are now subjects of change. Payment systems with the aforementioned three characteristics are referred to as the traditional Japanese payment system in this thesis, and the author shall compare the current systems in the case firms with the

traditional system, according to the three factors identified by this thesis as the basic factors constituting payment systems – job, market and person.

The first comparison is a change within the person factor. The traditional Japanese payment system is a person-based system for which the main factor is the input aspects such as personal characteristics (*zokujinteki youso*) and job-related ability (*shokumu suikou nouryoku*). However, in the case firms, there are two main differences from the traditional system. One is the emphasis on the output aspect of the person factor. All case firms directly link output performance, as measured in the performance appraisals, to pay. Furthermore, all case firms have been increasing pay differences by rating in the performance appraisals. The other is a change within the input aspect of the person factor. The case firms diminish or reduce emphasis on personal characteristics relating to seniority, such as age and years of service. In contrast, job-related abilities and/or competencies have been emphasised for pay increase. In particular, most case firms recently introduced competency pay.

The second comparison relates to the introduction of the job factor. While the person-based system is the main characteristic of the traditional Japanese payment system, three case firms implemented job- or role-related pay for all employees, and three case firms implemented job- or role-related pay to a proportion of their employees (mainly managers). In other words, the majority of the case firms implemented job- or role-related pay for at least some of their employees.

The third comparison relates to the introduction of market factors. Company JC1, Company JC2, Company JT2 and Company JT3 participate in market salary surveys for at least a proportion of their employees. Company JR1 gathers market pay data about each job family and employee level from firms in the same industrial sector (department stores). Company JC2 gathers market pay data about each employee level from firms in the same industrial sector (chemical). Compared with job- or role-related pay, the extent of use of market-related pay is not widespread. According to the case firms, the main reason is the difficulty of gathering market pay data.

As a result of these differences, pay profiles are changing. Alternatively, one could say that the purpose of changing the payment systems is to change pay profiles. There are two directions of change in pay profiles in the case firms. The first is establishing larger

pay differences by appraisal ratings among similar age groups with similar academic backgrounds. This is the primary purpose of the change in the case firms. The second is flattening age-pay profiles. This is not necessarily applied to all employees because the pay levels of all middle-aged and older employees do not necessarily decrease and some will receive higher pay increases than in the past. Nonetheless, flattening age-pay profiles is also considered a main purpose, because the case firms perceive that the current age-pay profiles are too seniority-related.

8.3.2 Sequence of change in payment systems in case study firms

As described above, the current payment systems in the Japanese case firms differ from the traditional Japanese payment system. This research found that changes in various aspects do not occur at the same time, and certain aspects of the change initiate other aspects. The sequence of change found by the research is shown using examples of the case firms.

- In 1993, Company JR1 changed to an emphasis on output performance and reduction of seniority pay through direct links between MBO, performance appraisals and pay. It introduced job-related pay in 1995 and market pay in 1999.
- In 1993, Company JC1 introduced an MBO scheme that links to performance appraisals and pays in order to emphasise output performance for pay. It introduced competency profiles in order to clarify behaviour criteria for measuring the process in 1995. It introduced job-related pay and market pay in 1997.
- Company JC2 established larger pay differences through appraisals in 1996. It introduced role-related pay for senior managers in 1999 and for below middle managers in 2000. It also introduced market pay when the role-related pay was introduced.
- Company JF1 has gradually increased pay differences through ratings and has reduced the seniority element since the early 1990s. It increased pay differences through ratings for managers in 2000 and for non-managers in 2002. It introduced role-related pay at the same time. In the future, it plans to introduce job-related pay based on analytical job evaluation and market pay.

As indicated, the changes started from increasing appraisal-related pay and decreasing seniority-related pay. In other words, pay differences through appraisal ratings became

larger due to the changes. But problems within the payment systems are revealed through these changes. That is to say, there are little objective and concrete standards for judgements of appraisals. The case firms increased pay differences according to the appraisal ratings without establishing objective and concrete standards for judgement of appraisal. This made the problems.

In the case firms, appraisal-related pay increases (*satei shoukyu*) have been implemented for a long time, but appraisal-related pay increases did not constitute a large proportion of overall pay increases at least until the mid career stage. Furthermore, stock-based systems can increase the correlation between contribution and pay levels in the long term. At the same time, as age was considered in pay determination, a pay increase higher than the inflation rate was guaranteed. Even employees with relatively low grades and pay levels after the mid career stage were not severely demotivated under this type of seniority-related pay. That is to say, the late selection practice, stock-based systems and seniority-related pay prevented or masked problems as little objective and concrete standards for judgements of appraisals.

The above characteristics are exemplified by referring to the payment system for non-managers in Company JF1 before the change in the payment system in 2002. *Kihonkyu chingin taikei* (elements of base-pay) before the change were *nenreikyu* (age-related pay), *keikenkyu* (year of service pay) and *shokunoukyu* (job-related ability pay). Pay increases in each type of pay are described below. The amounts of money indicated in table 8-1 to table 8-4 are pay increase amounts paid monthly in 2001. The first is age-related pay. The age-related pay increased annually regardless of appraisal ratings as described in table 8-1.

Table 8-1: Amounts of money for annual pay increase as age-related pay

Age	Amounts of money for annual pay increase
18 – 22 years old	¥ 3,000
23 – 29 year old	¥ 3,500
30—34 years old	¥ 2,000
35—49 years old	¥ 1,800
50—59 years old	0

The second is years of service pay. The years of service pay increased according to

years of service regardless of appraisal ratings as described in table 8-2.

Table 8-2: Amounts of money for annual pay increase as years of service pay

Years of service	Amounts of money for annual pay increase
1 – 22 years of service	¥ 1,000
Over 23 years of service	¥ 500

The third is job-related ability pay. The amounts of money for annual pay increases differed according to the appraisal rating category. Furthermore, the extent of the difference in pay increase money was differentiated by levels of *shokunou toukyu* (qualification grade based on job-related ability) and *gou*¹¹³ in each qualification grade. Annual pay increase money in the qualification grade 6 is shown as an example. Qualification grade 6 is the highest grade in the non-manager qualification grade (grade 6 is the highest and grade 10 is the lowest).

Table 8-3: Amounts of annual pay increase money as job-related ability pay

Qualification Grade	Gou	S	A	B	C	D
6	1—6	¥ 10,020	¥ 8,590	¥ 7,170	¥ 5,730	¥ 4,300
	7—	¥ 8,000	¥ 6,800	¥ 5,730	¥ 4,580	¥ 3,440

Notes: S – D are rating categories. S is the highest and D is the lowest. The distribution rate of each rating category is: S = hardly rated, A = 25%, B = 50%, C = 25%, D = hardly rated.

As described above, the influence according to rating categories is not large. In the case of 35 year old employees with qualification grade 6, *gou* 3, employees with the virtually highest rating¹¹⁴ receive an ¥ 11,390 pay increase as *teiki shoukyu* (regular pay increase) and employees with the virtually lowest pay rating get ¥ 8,530 as *teiki shoukyu*. Clearly, the pay difference according to ratings was small.

There are two elements of annual pay increase in Japan: *teiki shoukyu* (regular pay increase) and *base-up* as discussed in section 3.3.5 in chapter 3. Average amounts of pay increase money for *teiki shoukyu* and *base-up* for non-managers in Company JF1 between 1999 and 2001 are as follows.

¹¹³ *Gou* is the smallest pay unit within the pay table as described in section 3.3.4 in chapter 3.

¹¹⁴ Formally the highest rating is S, but as S is hardly rated, virtually the highest rating is A. The same situation is applied to the lowest rating. That is, formally the lowest rating is D, but as D is hardly rated, virtually the lowest rating is C.

Table 8-4: Average of amounts of money for annual pay increases for non-managers

	Average of annual pay increase money	Average of annual pay increase money as <i>base-up</i>	Average of annual pay increase money as regular pay increase
1999	¥ 7,726	¥ 1,000	¥ 6,726
2000	¥ 7,100	¥ 266	¥ 6,734
2001	¥ 6,721	¥ 100	¥ 6,621

Notes: Annual pay increase of *base-up* between 1999 and 2001 in Company JF1 is small as described in table 8-4. This small pay increase as *base-up* in Company JF1 is the same as the general situation captured by many surveys about pay such as *Chingin Kouzou Kihon Toukei Chousa* (Basic Survey on Wage Structure) conducted by MHLW annually. The main reason for this small *base-up* rate is recent economic situation as deflation. *Base-up* is the standard pay increase of organisations. Therefore, economic situations such as inflation and deflation strongly influence *base-up* rate (MHLW 2001, Nikkeiren 2002).

However, establishing large differences through appraisal ratings appears to be the problem. Firstly, the case firms dealt with this problem by changing appraisal processes to increase transparency and introduce the participation policy. For example, the disclosure of rating criteria and rating standards, and participation of appraisees for appraisal process were implemented. This is because the case firms perceived the problem of low procedural justice. The purpose of the change was to increase this.

However, some case firms felt that this change was not sufficient solve the problem, and they realised that a more fundamental problem was the lack of standards with high concreteness and objectivity for determining grades and pay levels. Under the person grade system, standards for individual contribution levels (in both input and output aspects) are not well established as they are for jobs under the job grade system. The case firms expanded pay differences through appraisal results without establishing standards with a high level of objectivity and concreteness for judging contribution levels related to grades and pay levels. This generated the problem. As a result, some case firms changed another aspect -- the introduction of the job factor, since the job can provide more concrete and objective standard. Although job evaluation includes subjective judgment, introduction of the job factor can increase the degree of concreteness and objectivity of standards for individual contribution levels relating to grades and pay levels.

The next step was the introduction of market pay for jobs. Once the case firms

introduced the job factor, linking market pay to jobs can increase the objectivity of pay determination compared with judgment only by internal relativity. However, the degree of introduction of market pay is smaller than job- or role- related pay. The case firms expressed difficulty in gathering market pay data under the spread of person-related pay. The spread of job-related pay in the Japanese labour market is a necessary condition for the spread of market pay for jobs.

As previously discussed, changes to payment systems in the case firms appear to be sequential. The stages of change are divided according to the three basic factors of job, market and person, as follows:

Change sequence

First stage – change within the person-based system

Change of relative emphasis within the person factor (reduction of seniority elements and establishment of larger pay differences through appraisal ratings).

This change accompanies a change from the stock-based to the flow-based system.



Change of appraisal processes in order to increase procedural justice.

This change develops from 'emphasis on long term sense of equity' to 'emphasis on sense of equity on each occasion of pay determination'. But, changing the appraisal process is not sufficient to solve the problem.



Second stage – introduction of the job factor

Introduction of the job factor to establish more concrete and objective standards for individual contribution levels in relation to grade levels and pay levels.

The second stage is associated with a change from the person-based to the job-based system.



Third stage – introduction of the market factor

Introduction of the market factor increases the objectivity of pay determination.

The third stage is associated with a change from the organisation-based to the market-based system.

Changing the relative emphasis within the person factor from age and years of service (personal characteristics) to contribution levels (input and output performance) initiates introduction of job and market factors. The main reason for this is the increasing objectivity within pay determination. The question is then raised as to whether an objective standard existed before the change? The objective standard might be age under *gakureki betsu nenji kanri* (which is an employee management method that treats cohorts with the same academic background who entered the firm at the same time as one unit of employee management as discussed in 3.6.3 in chapter 3). Age is a very objective criterion, however, the case firms cannot use this as the criterion if they wish to make large differences among the same age groups. Consequently, individual pay determination lost or reduced its objective standard. The case firms needed other objective standards instead of age. Job and market are alternatives types of objective standards for individual pay determination.

The payment system bundle in the case firms is changing from person-based to job-based (introduction of the job factor), from stock-based to flow-based. Further, symptoms of change from organisation-based to market-based can be seen, although the change is just at the primary stage. As a result, three characteristics identified as this thesis that form the bundle of the traditional Japanese payment system are changing.

In addition, emphasis on a long term sense of equity, which is one of the significant differences argued in this thesis, is also changing towards emphasis on a sense of equity on each occasion of pay determination along with the change from stock-based towards flow-based payment system. Moreover, employee interviewees expressed recent changes in promotion and pay determination practices in the case firms as discussed in chapter 6. Therefore, the psychological contract as 'pay for age' will possibly change, although the research could not confirm this. In contrast, the case studies could not find any change in the remaining factor of centralised decision making for individual pay determination, except in Company JT3 (UK-owned firm). This issue will be discussed in chapter 10.

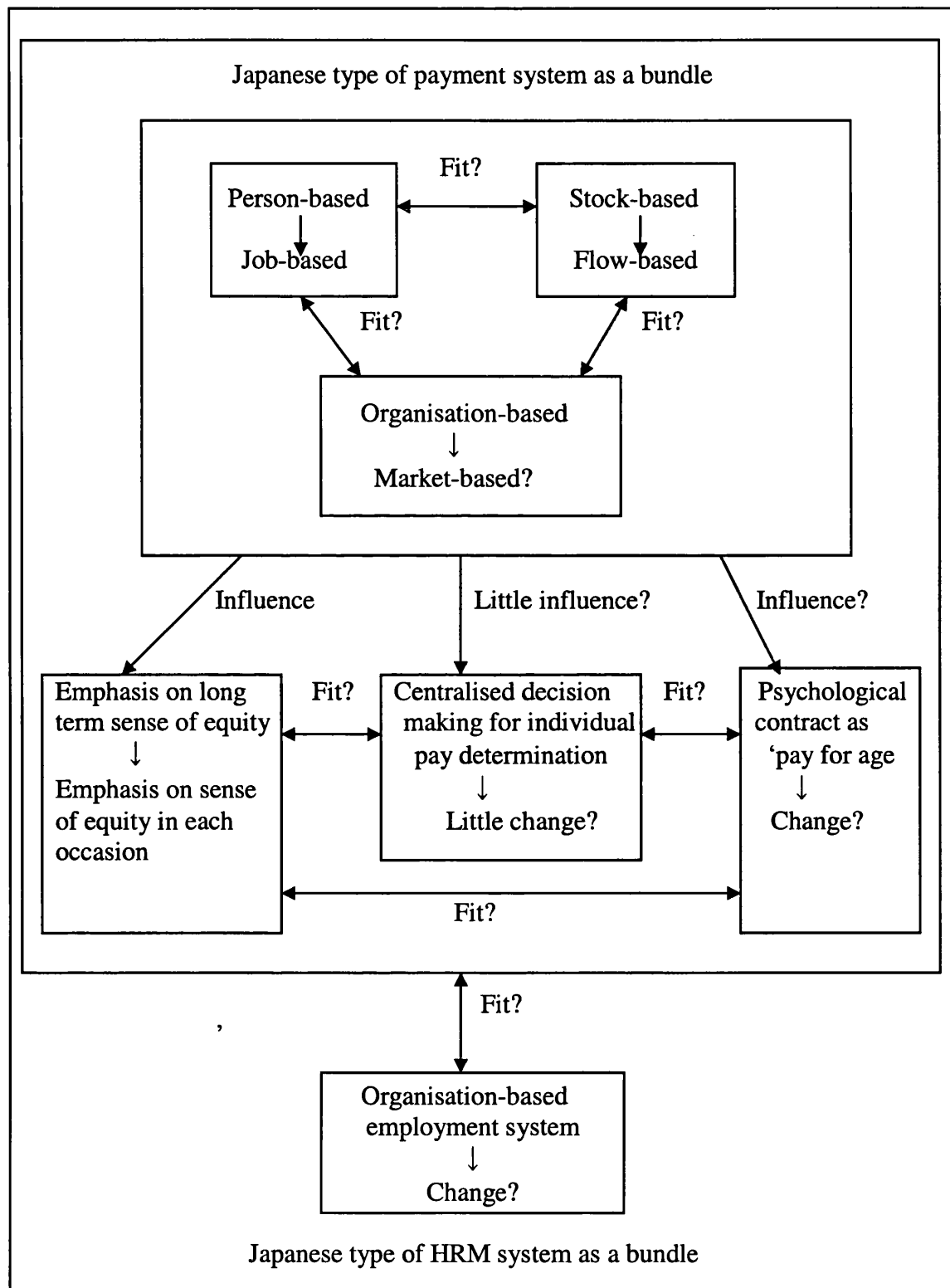
Furthermore, it is anticipated that the employment systems are changing in the case firms, from organisation-based to market-based. As the type of payment systems change, other aspects of the HRM policy should also change, because internal fit is needed between the individual HRM policies which make up the total HRM policy, if HRM

theory or the configuration perspective is applied. In general, lifetime employment policies have been decreasing according to the *Koyou Kanri Chousa* (Survey of Employment Management) carried out by the MWHL¹¹⁵, as discussed in Chapter 1. The relationship between employment policy and payment systems in the case firms will be discussed in the next chapter. Change in the case firms discussed so far is illustrated in figure 8-3.

Although this thesis has discussed the change sequence, not all case firms reached the third stage and not all realised that the reason is the lack of job and/or market factors. Only some firms have reached or plan to reach the second or third stage and thereby realise the cause(s) of the problems. Furthermore, this thesis argues that the case firms need an objective standard for individual pay determination and the objective criterion is currently changing from age to job and market rates. No case firms pointed out this logic. This is a hypothesis developed by the author based on the research findings.

¹¹⁵ Survey of Employment Management (*Koyou Kari Chousa*) is the highest validity in terms of number of subjects and response rate amongst the various surveys concerning employment policy.

Figure 8-3: Change on Japanese type of payment system as a bundle and relationship with the employment system



8.3.3 Differences in change stages amongst the Japanese case study firms

This thesis has pointed out three stages in a change sequence. Table 8-5 summarises change stage (included intended change) of each case firm in Japan.

Table 8-5: Stages of change in payment systems in Japanese case firms

First stage – change within person-based payment system	
Company JO1	No plan to introduce job and market factors
First stage – planned second stage (introduction of the job factor)	
Company JT1	It plans to implement the job factor
First stage – partially second stage – planned third stage	
Company JF2	The job factor has been partially implemented for managers through role-related competency profiles. Implementation of job grades is planned. After this, it intends to implement job-related pay and market pay.
First stage – partially second stage – partially third stage	
Company JT2	It has implemented role-related competency profiles for non-managers (job factor), but the pay structure did not change (person grade). Partial participation in market salary survey.
Mixture of first and second stages (mixture of person-based and job-based systems)	
Company JR2	Job-based system for managers, person-based system for non-managers. No information has been gathered about market pay.
Second stage – planned third stage	
Company JF1	Implementation of role-related pay, planned implementation of job-related pay based on analytical job evaluation schemes and market pay.
Second stage – partially third stage	
Company JT3	Role-related pay has been implemented. Partial participation in market salary survey.
Second stage – third stage	
Company JR1	Job-related pay has been implemented. Market pay for job families and employee levels has been gathered in the same industrial sector (department store).
Company JC1	Job-related pay has been implemented. Market pay for jobs has been gathered through participation in market salary survey.
Company JC2	Role-related pay has been implemented. Market pay for jobs has been gathered through partial participation in market salary survey and through pay data in the same industrial sector (chemical).

We can see from table 8-5 that there are no discernible differences in change stages according to industrial sectors. Examples are shown for three industrial sectors, in which more than two firms were researched, that indicate little difference by industrial sectors in the payment system change stage.

- Change stages of three telecom firms (Company JT1, Company JT2 and Company JT3) are different; Company JT1 is in the first stage, Company JT2 is in a mixture of the first, the second and third stages, and Company JT3 is between the second and third stages.
- Change stages of two food and drink firms (Company JF1 and Company JF2) are different; Company JF1 is the second stage (and planned third stage), and Company JF2 is in the first stage and partially in the second stage (and planned third stage)
- Change stages of two retail firms (Company JR1 and Company JR2) are different; Company JR1 is in the third stage and Company JR2 is in a mixture of the first and second stages.

Although Company JC1 and Company JC2 look to be in similar industry sectors according to the formal industrial category (the category is based on industrial categories on the stock exchange index), their business areas are rather different; the main business area of Company JC1 is pharmaceutical and Company JC2 diversified into many areas such as household products, cosmetics, food and chemicals based on its chemical technology (Company JC2 defines its business areas as business in which chemical technology, which is the identified core competence of Company JC2, can be applied).

As described, there is no evidence to indicate that industrial sector influences change stages in the payment systems, although the research predicted that there may be industrial effects for change of the payment system as discussed in chapter 5. That is the reason why this research selected the case firms from different industrial sectors. The reasons for no industrial effects being found to influence changes to the payment system will be discussed in the next chapter.

8.4 Changes of payment systems in case study firms in the UK

8.4.1 The main directions of changes in payment systems in case study firms in the UK

Payment systems in the UK case firms concerning job, market and person factors are static. That is to say, the payment systems continuously include these three factors. There are also little changes on the basic characteristics of job-, flow- and market-based systems.

However, within the same framework, there have been some changes in these case firms. Two main directions have been found -- changes in job evaluation methods and changes in pay structures. Job evaluation methods have been changing from a point factor scheme to job ranking or job classification. Pay structures have been changing toward more broadly and loosely banded structures. There are two main reasons for these changes. One is in order to strengthen links between individual contributions and pay. The other is to shift the relative focal point from internal relativity to external relativity. The two directions of these changes further strengthen the market- and flow-based payment systems.

The performance review function related to pay is also been changing in the some case firms. Formal performance management systems that assess performance based on specific objectives were recently introduced or in the process of being implemented in three cases firms (Company BT1, Company BF1 and Company BR1) at the time of the case studies. As the other case firms have already implemented performance management systems, relating these systems to pay has further spread among the case firms. The competency approach to performance reviews has also spread in the case firms, although the research has not succeeded in identifying the extent to which competencies are really assessed by line managers within performance and pay reviews. The increased focus on individual contribution is an older trend and the shift of focus from internal relativity to external relativity is more recent (since the 1990s, and especially since the mid 1990s).

It is clear that changing aspects in the payment systems are related to each other. For example, increased links between individual contributions and pay changes the

performance review function, job evaluation methods and pay structures. This close relationship between the changing factors in the UK case firms is the same as in the Japanese cases. If one part of the payment system bundle changes, it influences other parts of the bundle, since individual policies of the payment system needs to fit internally within the bundle. This interpretation is consistent with the configuration perspective.

8.4.2 Differences in changes amongst the UK case study firms

As with the Japanese case firms, industrial sector effects on the extent of change in payment systems in the UK case firms are examined. Two aspects of change are discussed here. The first is more recent changes such as changes in job evaluation methods and the pay band structure, and the second is longer term trends such as an emphasis on individual contribution for pay levels (related to the introduction of performance management systems). The first aspect of change in each case firm is summarised in table 8-6. Table 8-6 uses the term 'traditional type' to indicate the use of a point factor job evaluation and a narrowly and rigidly banded pay structure, and 'new type' to indicate the use of a non-analytical job evaluation (pay determination based on brief job descriptions plus market pricing) and a broadly and loosely banded pay band structure.

Table 8-6: Stages of change in payment systems in the UK case firms

First stage Traditional type – point factor job evaluation and narrowly and rigidly banded pay structure	Company BO1
Second stage Middle position between traditional type and new type	Company BF3
Third stage New type – non-analytical job evaluation (pay determination based on brief job descriptions plus market pay) and loosely and broadly banded pay band structure	Company BT1 Company BT2 Company BF1 Company BF2 Company BR1 Company BC1

As we can see, there are no discernible differences according to industrial sectors for changes in the job evaluation scheme and pay structure.

The second aspect of change is the increasing emphasis on individual contribution. This is more of a long term trend. Three case firms (Company BT1, Company BF1 and Company BR1) recently introduced the formal performance management system. As other firms had already implemented this system, all of the case firms had now introduced the performance management system. For the second aspect, the industrial sectors of three case firms that had newly introduced the formal performance management system are different. That is to say, there are divergences among the case firms in the same industrial sectors in terms of when the formal performance management system was introduced. This difference is shown in two industrial sectors in which more than two firms were researched.

- In the telecoms sector, Company BT2 has implemented the formal performance management across the organisation in the long term, and Company BT1 has newly introduced the formal performance management system.
- In the food and drink sector, Company BT1 newly introduced the formal performance management system across the organisation, and Company BF2 and Company BF3 have been using the formal performance management system for a long time.

As we have seen, no industrial effects were found for the second aspect as well as for the first. Therefore, no industrial effects were found for change stages in the UK case firms as in the Japanese case firms.

Although there are no discernible differences in change stages as discussed, the research found one common characteristic relating to industrial sector. That is the degree of focus on competencies relating to performance and pay reviews. Company BF1 and Company BF2 are the most positive among the case firms in using competencies overall in HRM, and performance and pay reviews as discussed in the 'competency section' in chapter 7.

On the one hand, no industrial effects were found to influence changes in the payment systems of the Japanese case firms. On the other hand, one recognisable industrial effect in the use of competencies was found in the UK case firms. Reasons for this difference will be discussed in the next chapter.

8.5 Summary

Firstly, this chapter pointed out differences between the payment systems in the case firms in Japan and the UK. Next this chapter discussed three particularly significant differences between the Japanese and UK payment systems found through the case studies. The three differences are; 'emphasis on the long term sense of equity', 'centralised decision making for individual pay determination' and 'psychological contract as 'pay for age'' for the Japanese case firms, and 'emphasis on sense of equity for each occasion of pay determination', 'decentralised decision making for individual pay determination' and 'psychological contract as 'pay for job and contribution'' for the UK case firms. One of the reasons why the author considers that the three differences are significant is that they support and increase the effectiveness of the basic characteristics in both the Japanese payment system as a person-, organisation- and stock-based system, and the UK payment system as job-, market- and flow-based system. While these differences were found to be based on empirical evidence from the case studies, they can be explained by the three basic characteristics for the Japanese and UK payment systems. Therefore, these differences are considered to be a consequence of the three basic characteristics. At the same time, they support and increase the effectiveness of the three basic characteristics in each type of payment system.

The case studies also found that the basic characteristics in the Japanese payment system are changing in the case firms. Further, the case studies found that changes in the three characteristics do not occur at the same time. Some aspects of change initiate others. This thesis analysed the change sequence and broke it down into three stages according to job, market and person factors. This type of change as sequence supports configuration perspective among three popular perspectives in HRM theory discussed in chapter 4. In contrast, the basic characteristics in the UK case firms do not change, although there are changes within the same basic characteristics.

The final consideration of this chapter was the examination of whether industrial sector influences the extent of change in payment systems. This research selected case firms from five industrial sectors as discussed in chapter 5, because the author assumed that there may be industrial effects on payment systems. However, there are no recognisable

differences according to industrial sector in the Japanese case firms. Correlations according to industrial sector were also hardly recognised in relation to industrial sector for UK case firms. However, the author found one recognisable difference in relations with industrial sectors for the UK case firms in terms of the degree of emphasis on competencies for pay purpose. The next chapter will examine how and why payment systems in the case firms are changing in relations with environmental change forces.

Chapter 9: Environmental change forces for payment systems in case study firms

9.1 Main environmental forces and HRM and payment systems in the individual case study firms

The recent changes in payment systems in the case firms in Japan and the UK were summarised in chapters 6 and 7, and chapter 8 compared the payment systems in case firms between Japan and the UK. This chapter will investigate the environmental forces for change in the payment systems in the case firms. Firstly, this section will summarise the situation in the individual case firms and their industrial sectors in terms of environmental forces and the main policies on HRM and payment systems in the individual case firms. Descriptions of the individual industrial sectors and case firms are mainly based on the information gathered from the case firms. Published information other than from the case firms is also used. References in the descriptions are only given for information published by parties other than the case firms. The descriptions are limited to the situation between 2000 and 2002 when the case studies were conducted.

9.1.1 Case study firms in Japan

Telecom industry

Over the last ten years, the technology and business areas in the telecom sector have been changing very rapidly and radically, for example the shift from fixed phones to mobile phones and from voice communication to data communication. Now, telecom firms face strong cost competition in voice services for fixed phones and profit from this business has been declining (Nakamura 2001, Nikkei Communication 2001). These environmental changes require a change in employee profiles. However, there are labour shortages in new technology areas. There are many overseas-owned firms and new venture firms in the telecom and high tech sectors that share a labour market with the case firms. These firms recruit workers with skills required by new technology areas for high pay levels. As promotion and pay tend to be seniority-related in the case firms, they have difficulty in offering high pay levels to young workers with new types of skills. Thus, the case firms change their payment systems in order to recruit and retain young workers with skills in new technology and business areas¹¹⁶. Now as the financial

¹¹⁶ The degree of the retention problem differs among the three telecom firms. Company JT2 does not have a retention problem unlike Company JT1 and Company JT3. Company JT2 thinks

results in IT or high tech industries are not good due to the so-called IT or high tech recession, the recruitment and retention problem is mitigated. But the three firms predict that the basic trend will not change in relation to the shortage of a workforce with the required skills. At the same time, three telecom case firms have an excess number of employees with skills in the old business areas. These employees tend to get high pay levels under seniority-related pay. This is also a problem due to increased competition. A change of pay cost allocation is needed in the three firms. The concrete situation and how to deal with these problems are different between the three firms.

Company JT1

Company JT1 was established in 1984 based on the former national railway firm that was privatized in 1987. Company JT1 has full-line telecom services as a network provider, including fixed phones (local, long distance and international), mobile phones and data services. The financial situation of Company JT1 is not good. Its operating profit reduced by 20.3% in the financial year ending March 2002. A UK mobile phone firm (one of the UK case firms) acquired 70% of the shares in Company JT1 and made Company JT1 subsidiary in 2001. Company JT1 is shifting business area from the voice phone business toward the data business. Company JT1 needs workers to develop new business areas, but the number of these workers is small. Instead, there are many employees who have the old types of skill used in the voice phone business, and they tend to be middle- or older aged. Although the data business is more promising, the voice business is still the main business area. Therefore, employees with the old skills are still needed. Morale and motivation of these employees are important. At the same time, the firm has to offer high pay levels to employees with the skills required by new technology and business areas. Company JT1 changed its appraisal and payment systems in order to reduce the seniority element and emphasise individual contributions in order to recruit and retain young competent workers. Company JT1 now faces further changes after being taken over by the UK telecom firm in 2001. Substantial changes in the HR area started in 2002 after the appointment of a new CEO chosen by the UK parent firm in December 2001. The new CEO changed the report structure to clarify individual responsibility. Before the change, there were many employees with unclear roles such as *tantou buchou* and *chousayaku* (director and manager without line

the position of Company JT2 as an industrial giant in the mobile phone market in Japan and the high levels of biannual regular bonuses due to good financial result are the reasons, although the financial results reduced in terms of ordinary profit in the 2002 financial year.

positions) as discussed in section 6.6 in chapter 6. However, there are no such positions in the new report structure. In 2002, during the final stage of the research for Company JT1, it planned to change the grade and payment systems to deal with the new report structure. A large number of grade promotions and demotions were anticipated, associated with the change of the report structure.

Company JT2

Company JT2 was established in 1992 as a mobile phone network provider as part of a group of the former public sector monopoly that was privatized in 1985. Company JT2 has the largest sales turnover in the mobile phone business in the world (Nikkei Business 2001). Its market share in mobile phones in Japan is 57% (03/2001). As the mobile phone business has been rapidly growing, the financial result in terms of operating profit for Company JT2 is very good. The main problem for Company JT2 in the HR area is that many employees with obsolete skills were transferred from the former parent firm, since the fixed phone business had bad financial results, although the number radically reduced after the transformation of the parent firm to a holding company structure in 1999. Many transferred employees have the old telecom skills that cannot be applied to the mobile phone business. However, their grade and pay levels are likely to be high under seniority-related promotion and pay. On the other hand, many new employees recruited after the establishment of Company JT2, have skills and knowledge which are applicable to the mobile phone business. As they tend to be young, their grade and pay levels are generally not high. Thus, there are large divergences between individual contributions and pay levels among employees. Company JT2 needs to offer high pay levels in order to recruit and motivate young competent workers. Company JT2 is now changing its promotion and payment systems to reduce seniority elements and increase the influence of appraisal results. Another main policy for solving the problem is the plan which Company JT2 establishes many subsidiaries and transfer old employees with old skills. The transfers will be associated with pay decreases. Another HR problem in Company JT2 is the shared grade structure and base-pay levels for each grade among the group firms. As the financial results of some group firms are bad, average pay levels cannot be increased even though the financial result of Company JT2 is good. This can decrease satisfaction and motivation of employees, particularly among employees who joined Company JT2 and did not transfer from

group firms¹¹⁷. The solution is making a large difference to promotion and pay, according to appraisal results.

Company JT3

Company JT3 was established in 1986 as an international telephone firm. Toyota, the C. Ito Corporation and Cable & Wireless were the main shareholders at the time. Although Company JT3 was technically supported by NTT (Nakamura 2001), the current parent firm (one of the UK case firms) took over Company JT3 in 1999. After the takeover, Company JT3 changed various aspects in their HRM system, such as grades, appraisal and payment systems. The UK parent firm strongly perceives that seniority-related grade promotions and pay increases are problems. The report structure changed and the positions of many employees changed according to the change in this report structure. Many former managers were demoted to staff level jobs and vice versa in terms of actual job level. At first, Company JT3 did not change its grade system (person grade system), and this made a large divergence between actual job levels, and grade and pay levels. Company JT3 introduced a role grade system in order to establish consistency between job levels and grade levels. However, pay levels of employees whose grade levels were demoted were not decreased, due to the refusal of senior managers dispatched by the UK parent firm. The reason for this refusal was that pay decreases usually do not happen as discussed in the previous chapter. This increased the pay cost of Company JT3. Company JT3 introduced performance management by using the UK parent firm as a benchmark. Before this, corporate HR coordinated and finally decided ratings for appraisals. But now, line managers have the final decision making power for appraisal ratings.

Food and drink industry

The speed of change in the market, technology and globalisation are relatively slow in the food and drink industry. Yet, global competition has been gradually proceeding and the product life cycle for food and drink products has become shorter. Customer consciousness for healthy food and drink is increasing (Suzuki 2001). Firms in the food and drink industry have to develop new products within a shorter period. Research and development power has become more important for the business. The customer interest in price increases during recession and deflation. Food and drink firms find that they

¹¹⁷ Transferred employees are less likely to be dissatisfied, since transfer from the former parent firm to Company JT2 includes an element of luck. They may have transferred to other group firms with bad financial results.

have to reduce cost. However, consumer preference for value added products becomes high at the same time. Consumers tend to buy high price products if they can recognise a high value. Customer orientation is more important for the development of new products. Changes in the retail industry, such as the expansion of convenience stores and new types of cheap retailers, influence the food and drink industry. For instance, large convenience store chains have strong purchasing power and this strong power shifts the power relationship between manufacturers and retailers to increase the power of retailers. As a result, retailers are more demanding, and firms in the food and drink industry are required to deal with this demand by offering high quality products and service at low cost.

Company JF1

This is the second ranked food-processing firm in Japan. The financial result of Company JF1 is very good. It increased its operating profit by about 30% in the financial year ending March 2002. Company JF1 sets financial targets in terms of sales turnover and profit. Emphasis on profit is the general tendency of all of the case firms, including Company JF1. Now Company JF1 is undertaking a restructuring, including the introduction of *shanai bunsha* (internal company system), making former divisions into subsidiaries and the promotion of alliances and acquisitions to deal with changing market competition in order to achieve the financial targets. Company JF1 thinks that the change in the market and its strategy will be faster than in the past. Past experience is less important within changing business environments and strategy. Company JF1 is changing its HRM system to reduce seniority elements and emphasise individual contributions. Company JF1 sets two objectives for changing the HRM system; the establishment of an HRM system to deal with increasing labour mobility between firms, and the establishment of a global HRM system. Company JF1 considers that a quicker change of its organisation strategy may decrease long term employment. The Japanese labour market may also change overall in favour of decreasing long term employment and increasing labour mobility. Therefore, Company JF1 regards the establishment of a new HRM system to deal with increased labour mobility as necessary.

Company JF2

Company JF2 attained the top position in the Japanese beer market in 2001 and has about 40% of the market share. Before releasing its new brand beer in 1987, the market share of Company JF2 in the Japanese beer market was about 9 to 10%. The new brand

beer increased the market share of Company JF2, and it has consequently been expanding its business and organisation. However, cost competition between beer makers has intensified. This decreased the profit of Company JF2. Another point to consider is how deregulation of alcohol retail, which starts in 2003, should be dealt with. Company JF2 anticipates that having a variety of alcohol products will become important to continue doing business under deregulation. Company JF2 is now expanding its product lines, in terms of types of alcohol products and brands, through acquisitions and alliances. Company JF2 emphasises the increase of sales turnover and profit as Company JF1 does. A change in the shareholder structure towards decreasing stable shareholders and increasing foreign shareholders is one of the reasons for emphasising profit. Company JF2 is changing its finance method to reduce bank loans and increase market capital. Individual shareholders become more important through this change in financial strategy. Company JF2 is changing its HRM system, including its payment systems, to reduce seniority elements and put more emphasis on individual contributions. In particular, grade promotion practices have been changing over the last few years and have become more selective based on individual contributions.

Retail industry

There are two categories of large firm sectors in the Japanese retail industry; department stores and supermarkets. Both have diversified. In particular, supermarket chains diversified to other types of retail business such as convenience stores and specialty stores, and these are now major businesses for many large supermarket chains. Department stores and supermarkets had difficulties after the collapse of the bubble economy. There are mainly two reasons for this. One is the continuous decline in sales turnover since 1992. The other is the large amount of debt derived from over-investment before the collapse of the bubble economy which was used to open new stores and diversify into new businesses. As finance for these investments was mainly raised by bank loans, many supermarkets and department stores have heavy debt following the collapse of the bubble economy (Ito 1999, Soeda 2000). There are other threats surrounding supermarkets and department stores, such as a change in consumer behaviour towards increased price consciousness, the shortening of product life cycles, expansion of new types of retailers such as convenience stores, discount stores and many types of specialty stores¹¹⁸, deregulation and inward investment of large overseas

¹¹⁸ While large supermarket chains invest in convenience stores and specialty stores, firms in other industries such as oil, electronics and food also invest in these types of stores.

retailers. The retail industry was strongly regulated, in particular by a law that limited opening of large-scale new stores, which was implemented in 1974. The law was loosened in 1994 and this increased competition amongst large Japanese retailers. Loosening of the law also encouraged investment by overseas-owned large retailers. For example, Wal-Mart, Costco and Carrefour invested in Japan. Japanese retailers are smaller than overseas-owned large retailers, mainly due to the effects of the law that limited the opening of new stores. Furthermore, as the law decreased market competition, the competitive power of Japanese retailers tends to be weak. The small scale and weak competitive power are problems in Japanese retail firms.

Company JR1

Company JR1 is the fifth ranked department store that operates all over Japan. Company JR1 has serious financial problems due to heavy bank debts stemming from large-scale investment before the collapse of the bubble economy. The former top management team resigned, taking responsibility for the financial problems. After the appointment of the new CEO in 1992, Company JR1 started restructuring in order to increase operating efficiency. As a result, cost reduction was achieved and operating profit was improved. However, Company JR1 still has substantial bank debt. As the increase in sales turnover cannot be predicted during economic downturn and the increased price consciousness of consumers, cost reduction is necessary. Company JR1 is changing its employee profile to decrease *seishain* (permanent and full-time employees) and increase part-time employees, and also to decrease employees who deal with management and increase employees who deal directly with sales, in order to reduce personnel costs. Company JR1 is changing its HRM system to reduce long term employment and strengthen employee selection. The basic principle for pay in Company JR1 is making consistency between job, contribution (especially output performance) and pay levels, and it changed the payment system in accordance with this principle.

Company JR2

Company JR2 is the fifth ranked supermarket chain, which mainly operates in central Japan. The financial result of Company JR2 is relatively good amongst the large supermarket chains. The turnover of Company JR2 has increased since 1992, although turnover has fluctuated each year. The increase in turnover mainly comes from

investment in new stores and the renewal of existing stores. As Company JR2 does not have heavy debt, it is able to carry out continuous investment mainly within its cash flow (Ito 1999, Soeda 2000). As a large increase in turnover cannot be expected during recession and strong competition, cost reduction is necessary. As the personnel cost is one of the major costs of supermarket chains, a reduction in this is strongly required. Company JR2 is further changing its employee profile to decrease *seishain* (permanent and full-time employees) and increase part-time employees, although there is already a high proportion of part-time employees as that is the general tendency in supermarket chains. Selection for promotion among permanent and full-time employees has been strengthened. The payment system was changed to reduce the seniority element and increase consistency between role, contribution levels and pay levels.

Chemical and pharmaceutical industry

Company JC1 and Company JC2 are categorised as part of the chemical and pharmaceutical industry. However, the business areas of the two firms are rather different. Company JC1 focuses more on the pharmaceutical business than the chemical business, and Company JC2 diversifies many business areas including household products, cosmetics, food, pharmaceuticals and industrial chemicals. As Company JC2 has diversified many areas, business areas of Company JC2 is not clearly defined (Company JC2 is categorised by chemical as industrial sector in stock exchange index). The industrial analysis focuses on pharmaceutical side that is the main business area of Company JC1. The pharmaceutical industry is strongly influenced by health care policies and government regulation. In Japan, regulation has been gradually reducing or changing. For example, until 1999, clinical research data gathered in foreign countries was not accepted for the approval of new drugs in Japan. However, since 1999, the government has accepted foreign clinical research data. This change made overseas-owned pharmaceutical firms positive regarding investment in the Japanese market (Suzuki 2002). The problem for Japanese pharmaceutical firms is their small size. For instance, the largest pharmaceutical firm in Japan (Company JC1) is number 15 in terms of sales turnover in the world ethical drug market. As investment in the development of new medicines increases, scale has become more important. There have been many large-scale mergers and acquisitions between the large US and European pharmaceutical firms since the 1980s as a response to the need for large-scale investment. However, large-scale mergers and acquisitions have not occurred in Japan. This makes the difference of scale between large MNCs (Multi-National Corporations)

and Japanese pharmaceuticals even larger.

Company JC1

Company JC1 is the largest pharmaceutical firm in Japan, and it has achieved high profit over the last several years. However, Company JC1 is 15th in the world for sales turnover and is less than one-sixth of the size of the world's largest pharmaceutical firm (Pfizer) in the world ethical drug market (in 2002). As size becomes more important to pharmaceutical firms due to the large scale of investment required for the development of new drugs, this large difference is a problem for Company JC1. Company JC1 set financial targets for both turnover and profit. Some strategies have been determined to overcome the problem and achieve the financial targets, such as the promotion of mergers, acquisitions and alliances, the strengthening of research and development capabilities, cost reduction and organisational restructuring, including *shanai bunsha* (internal company system). Company JC1 achieved financial success in both turnover and profit. It reduced its number of employees from 12,000 to 7,000 between 1996 and 2000, and plans to further reduce this to 5,000 through *kibou taishoku* (voluntary turnover)¹¹⁹ and restraining recruitment. Emphasis on contributions, especially output performance, for pay and promotion is one of the main strategies in order to achieve the financial targets. As Company JC1 has achieved high profit, it attracts foreign investors. The proportion of shareholding by foreign investors is 30.1% (as of 31st Sep. 2002). This high proportion of foreign investors has increased the demand for profit.

Company JC2

Company JC2 continues to achieve high profits. One of the strengths of Company JC2 is its development of new value added products. Old household products tend to become targets for cost competition. For instance, one of the main products of Company JC2 is detergent and this is now under strong cost competition. In order to avoid cost competition, Company JC2 has a differentiation strategy through its continuous development of new value added products. Therefore, the quality of employees is very influential for the business results of the firm. Company JC2 often changes its HRM system in order to maintain its strengths. Company JC2 sets two main targets within HRM; one is to ensure consistency between role and contribution levels, and grade and pay levels, and the other is to create a new type of employment relationship alongside the reduction in lifetime employment. The high profit of Company JC2 attracts foreign

¹¹⁹ Word '*taishoku* (turnover)' is used instead of '*yojyou jinin* (redundancy)' in Japanese firms.

investors. The proportion of foreign investors is 35.4% (as of 31st Sep.2002). The foreign investors require high profits, as in Company JC1. Company JC2 is positive towards the attraction of investors in order to strengthen its financial situation. Making an explicit link between shareholder value and pay is one of the concrete policies which will attract investors.

Oil industry and Company JO1

Until the mid 1990s, the oil industry was strongly regulated by the government. It intervened in the volume of oil refinement allowed for each oil firm. Under the strong intervention of the government, competition among the oil firms was not strong and efficiency was not strongly pursued. However, the government started deregulation in the late 1990s and this encouraged competition. As the government has regulated the oil industry, rationalisation has not progressed and oil firms tend to be small in Japan compared with the major oil firms in the world market. Furthermore, large-scale mergers and acquisitions have been conducted on a global scale. Major overseas-owned oil firms have become even larger. Pressure from global competition becomes stronger through deregulation policy. In order to deal with the deregulated situation and to compete with large overseas-owned oil firms, some mergers have been carried out in oil firms in Japan (Kakimi 1998, 1999, 2000, 2001). Company JO1 is the largest oil firm in Japan and was established by the merger of the former largest Japanese oil firm and the sixth largest in 1999. After the merger, cost reductions, including personnel costs, have been pursued. The firm reduced personnel costs mainly by reducing the head count. It implemented a *kibou taishoku* (voluntary turnover) programme and reduced the number of employees from about 5,200 to 4,600 between 1999 and 2000, and it plans to further reduce the number to 2,500. The merger strengthened the selection of employees, particularly for managers, including down-grading. Company JO1 recently allied itself with the third and fourth ranked oil firms. Company JO1 has initiated the mergers and restructuring of the Japanese oil industry so far.

9.1.2 Case study firms in the UK

Telecom industry

Privatisation of the UK telecom market started in 1981. In particular, after the abolition of the duopoly policy in 1991, many operators supplying local, national and international fixed line services entered the market and market competition increased

(Key Notes 2000a, 2001a, 2002a). Alongside increased market competition globally and domestically, the progress of technology is very rapid. This has created new markets in the telecom industry. The mobile phone market is the most notable example. The market penetration rate of mobile phones in the UK was 79% at the end of 2001 (Nippon Keizai Newspaper 2002a). Until 2000, IT businesses including telecoms were prosperous. However, the IT business has been facing a downturn, the so-called IT or high tech recession, since 2001. Large telecom firms now have financial difficulties due to large investments in new technologies and new businesses. Generally, the share prices of telecom firms have been decreasing since 2001. The rapid change in technology has led to a change in employee profiles. Until 2000, under the business boom, telecom firms had difficulty in recruiting and retaining talented people. That was the age of the so-called 'war for talent'. Since 2001, the difficulty of recruiting and retention difficulty has relaxed, but it is still a continuously important agendum for telecom firms within the rapidly changing technology and market.

Company BT1

Company BT1 is the largest mobile phone network provider in terms of number of customers in the world market. Company BT1 has expanded its business rapidly alongside the expansion of the mobile phone market. Its sales revenues and operating profits continuously increase. However, pre-tax profit levels have radically decreased since 2001. There are two main reasons for this. One is the decrease in share prices of telecom firms in which Company BT1 invests. The other is the delay in implementing the third generation service due to delays in content development, despite heavy financial investment in obtaining permission for the third generation license (Key notes 2001a, 2002a). In the UK, the mobile phone market has already become saturated and therefore, the high expansion that Company BT1 experienced in the past cannot be expected. In the past, Company BT1 retained and motivated employees by offering good promotion opportunities and high pay levels. However, Company BT1 cannot offer good promotion opportunities for many employees any more. This change in the business situation requires change in the HRM systems. In 2000, Company BT1 introduced new performance management systems, including competency profiles. Company BT1 needs to offer other types of rewards instead of high promotion and pay. The provision of development opportunities is one of them, and competency profiling is one of the concrete policies. Furthermore, as the UK mobile phone market is saturated, increased turnover per customer is needed in order to increase overall company turnover

and profit. This requires the development of new services, such as various types of new data communication services, and this changes employee profiles. The strengthening of the selection function, and the retention, motivation and development of selected employees become more important. The introduction of performance management and new competency profiles are the concrete policies to achieve these aims.

Company BT2

This is one of the world's leading global telecom firms. Company BT2 has been restructuring its business areas since 1999, after the appointment of the current CEO, in order to concentrate on B to B business through IP (Internet Protocol) (Key Notes 2002a). This strategy is based on the prediction that the IP business will expand. However, the expansion of IP business has been slow due to a slowdown in the IT business (Key Notes 2002a). Company BT2 has difficulties in HRM areas due to bad financial results. For example, Company BT2 had no annual pay review in 2001. Whilst the recruitment and retention problem relaxed after 2001, these continue to be key issues within rapidly changing technology and markets. Company BT2 uses various assessment and selection policies, such as risk assessment on employee turnover, in order to select valuable employees and to reward them. Company BT2 changed its payment system to market driven pay determination in order to deal with the rapidly changing business environment. Despite various attempts in the HRM area, the problems made by bad financial results cannot be solved only by HRM. For instance, an employee survey in Company BT2 shows high satisfaction of employees with a financial reward system, on its principles and processes. But this research found employees' dissatisfaction with low financial reward from interviews with HR practitioners and other employees. Company BT2 may have a sophisticated HRM system, but low pay increases and the low level of other financial rewards caused by bad financial results cannot be solved only by sophisticated HRM systems.

Food and Drink industry

In both food and drink businesses, market structures are polarised between large and small firm sectors, and the market of the large firm sector has been increasingly concentrated on a small number of major firms due to large scale mergers and acquisitions in recent years. There are some global major firms in the UK within the food processing and alcohol manufacturing sectors. The strategic style of these firms is characterised by portfolio management, because the firms tend to invest and divest in

various business areas, including unrelated areas. In particular, alcohol drink firms have a strong tendency for this type of strategy. However, the portfolio strategy is considered old-fashioned. Recently, the firms in the alcohol business have been focusing more on their core business and have divested from non-core businesses (Key Notes 2000b, 2000c, 2002b). In the food processing industry, profit margins are generally small. Small margins and over capacity are continuous problems for dairy products in the food processing sector. As value added products such as convenience foods have higher profit margins amongst the product lines, a shift to value added products has become increasingly important.

Company BF1

Company BF1 was formed in 1961 by the merger of three alcohol manufacturers. Company BF1 frequently changed its business portfolio through numerous buying and selling activities (Whiteley 2000). After the appointment of the current CEO, Company BF1 has been focusing more on its core businesses of spirits and quick service restaurants. It sold its pub operations in 1999. Now, about 90% of the sales revenue comes from the spirits business. Company BF1 has the second largest share in the world spirits business. However, the largest firm (Company BF2) has more than triple the revenue of Company BF1. This situation influences the organisation and HRM strategies of Company BF1. In order to compete with the industrial giant company in the spirits business and to prevent being taken over by other firms, Company BF1 set financial targets of double-digit growth in both revenue and profit. New policies in the HRM area are aimed at achieving this. The HRM policies are 'right people, right place', 'right reward' and the 'spread of HRM best practice'. In the 'right people, right place' policy, global competency profiles were developed and competency assessments are now being implemented for all employees. Within 'right reward', a new reward policy is now being implemented. The concrete policy includes emphasis on variable pay relating to organisational performance, the establishment of pay for individual contribution, the introduction of competency assessments related to pay, a change in the pay structure to broadly and loosely banded and the introduction of job family pay structures. Company BF1 considers that as the drink industry is a relatively stable industry, it can have an entitlement culture. Culture change is necessary to achieve double-digit growth and reward systems can mean culture change contributes to the performance culture. At the same time, employee development is needed to grow the alcohol business whose market has already matured. Implementation of competency

profiles is the concrete approach for the emphasis on employee development.

Company BF2

Company BF2 was established by two former UK-owned food and drink firms in 1997. At the time of establishment, the business portfolio of the firm included spirits, beer, packaged food and quick service restaurants. The spirits business is the largest part of Company BF2. It has a top share in the world spirits market. Before the merger, the former two firms frequently invested and divested in many business areas both within and outside of the food and drink business. After establishment, Company BF2 has been concentrating on its core alcohol business – spirits and beer. Company BF2 divested from the packaged food business and is now in the process of divesting from the quick service restaurant business. As the large expansion of alcohol consumption in the advanced countries that are the main targets of Company BF2 cannot be expected, market success mainly comes from the development of value added drinks and a marketing strategy based on the customer perspective. Therefore, Company BF2 thinks that people make a difference to the business more than in the past. One of the former companies introduced a new payment system and performance reviews in 1996. The new system included changing the job evaluation method from point factor scheme to a skill and competency-based, changing the pay structure to one which is broadly and loosely banded, and the introduction of performance reviews linked to competency assessments. This new system became the basis for performance reviews and payment systems in Company BF2. Company BF2 links pay and career development through competency assessments and assessments of career potential. Company BF2 is positive in using multiple information gathered from 360 feedback for individual pay determination.

Company BF3

Company BF3 invested in many areas including non-food businesses, and transformed into a conglomerate during the 1970s and 1980s. However, Company BF3 has focused on its Pan-European food business and UK distribution business since the 1990s. In particular, Company BF3 has been focusing on convenience foods since the late 1990s (Salamie 2000). Like the drink industry, the food industry is mature. Expansion of consumption in the food business as a whole cannot be expected. The development of value added products that can avoid cost competition is the key strategy in Company BF3. At the time of the research (2000), Company BF3 planned to change its appraisal

and payment systems for blue-collar workers. Historically, shopfloor skill is low in the food industry, yet Company BF3 planned to change its HRM system for blue-collar workers in association with its focus on value-added products. However, revenue and profit have decreased since 2001 due to the demerger of its profitable logistics business, and foot and mouth disease. The CEO was replaced due to the serious financial situation. Further research of Company BF3 was refused under the circumstances.

Retail industry and Company BR1

The supermarket is the major player in the retail industry in the UK. Market concentration in the retail industry in the UK is higher than in Japan and the market share held by large supermarket chains in the UK is higher than in Japan (Key Notes 2002c). Company BR1 is the largest supermarket chain in the UK. In the year ending 11th February 2002, sales turnover increased by 12.7% and profit before tax increased by 14.1%. Grocery goods are the main business for UK supermarket chains. Since the 1990s, supermarket chains have developed their own brands in order to increase their margins and to target specific niches of food demand. Company BR1 is positive for the development of many new own-brand products and develops 200 new products annually. Large supermarket chains including Company BR1 are also positive to invest in non-food businesses such as financial services, leisure and household services (Key Notes 2001b, 2002c). Furthermore, Company BR1 invests in foreign countries such as Continental European countries and Asian countries. These positive investments influence its HRM system. Company BR1 introduced a new performance management system in 2000. Before the introduction, there was no established guideline within the organisation regarding setting objectives. Objectives were set by line managers unilaterally, or simply were not set at all. Competency assessments are included in the new performance reviews. The development function in performance management has been strengthened. It planned to change the pay structure to a broadly and loosely banded structure by 2002, in order to increase adaptability for the market and individual contribution (the research for Company BR1 was in 2000). Company BR1 thinks that a narrowly banded pay structure facilitates vertical promotion, but flattening the organisation reduces vertical promotion opportunities. The pay structure should adapt to new organisational structures.

Pharmaceutical industry and Company BC1

This research combined the chemical and pharmaceutical industries, as they often

become one business portfolio within a firm. Company BC1 was researched as a chemical and pharmaceutical firm. However, Company BC1 demerged its chemical business in 2002 in order to concentrate on its core pharmaceutical business, which was its major business before 2002. Therefore, only the pharmaceutical industry is described here. The UK is one of the leading countries in the pharmaceutical industry. The second and fourth largest pharmaceutical firms in the world market are UK-based (in 2002). 37.7% of all UK research and development expenditure was directed to pharmaceuticals in 2000 (Key Notes 2002d). The domestic pharmaceutical market in the UK is the sixth largest in the world. Although the domestic medical market in the UK is much smaller than in Japan, the scale of large pharmaceutical firms in the UK is much larger than that in Japan. Company BC1 was established by a merger of former UK and Swedish chemical and pharmaceutical firms in 1999. The merger formed the fourth largest pharmaceutical firm in the world (in 2002). As Company BC1 is a research-based pharmaceutical firm, the development of medicines is critical for business success. It is often pointed out that results-based appraisals and pay determination are not suited for research and development areas due to the difficulty of qualitatively measuring results in the short term (Randal 1997, Brown and Armstrong 1999, Kessler and Purcell 1992). Soft approaches such as development focused performance management, the introduction of competency profiles and 360 degree feedback are often exemplified in pharmaceutical firms, as these approaches tend to focus on qualitative aspects and facilitate links between assessment and development functions (Brown and Armstrong 1999, Armstrong and Baron 1998, Randal 1997). Company BC1 emphasises the soft approach to performance reviews. For instance, Company BC1 focuses on development in performance management and does not decide ratings during performance reviews. Fixed job contents and pay attached to fixed job contents can reduce the creativity of researchers. Furthermore, the provision of market competitive pay levels is critical in order to recruit and retain knowledge-based workers. Company BC1 has a broadly and loosely banded pay structure and market driven pay in order to increase adaptability to the labour market and the value of individuals.

Oil industry and Company BO1

Large scale of mergers and acquisitions has been proceeding in the global oil market. Company BO1 was acquired by a major UK-owned oil firm (the third largest oil firm in terms of revenue in the world market) in July 2000. Company BO1 is now one division of this oil firm. Large-scale mergers and acquisitions occurred and market concentration

has been proceeding in the oil industry. The reason for the acquisition of Company BO1 was the expansion of the lubricant business. According to interviewees in Company BO1, the management style of Company BO1 was paternalistic, although it has been changing recently. Long term employment and internal promotion policies were the main policies under paternalistic management. The payment system in Company BO1 was the most traditional one amongst the eight case firms in the UK. However, the interviewees expressed the view that the management style changed in the last few years because of bad financial results, and it would further change in the near future, since the new parent firm has no paternalistic management. Whether the payment system changed after the acquisition cannot be confirmed, because further research was not accepted.

9.2 Approach to the major environmental forces for change

The next step is the identification of the main environmental factors that have been encouraging change in the payment systems of the case firms. The basic framework adopted by this thesis to understand the relationships between external and internal environments and payment systems, is the open systems or contingency perspective, as discussed in chapter 4. The concrete relationships between them are illustrated in figure 4-1, 'Model of Strategic Change and HRM' by Hendry and Pettigrew (1992) in chapter 4. Now, this thesis will consider the concrete relationships between outer and inter contexts and payment systems within HRM content, as indicated by solid arrows in figure 4-1, concerning changes in payment systems in the case firms.

The environmental factors discussed are based on information gathered from the case firms. There are two types of environmental forces for change. The first type is those directly pointed out by the case firms as reasons for their changes. The second type is those that case firms perceive as change forces in the background situation, but they did not point them out as reasons for their changes. For example, internal documents and interviewees in the case firms often indicated the general trends of HRM, including payment systems, and they compared the general trends with their own systems in order to decide on the direction of their changes. However, no case firms pointed out the general trends as a reason for their changes, e.g. 'the reason for the change is to follow the recent trend'. Therefore, even though the case firms do not directly mention them, the author has included forces for change where she judged that environmental factors

influenced the change in payment systems in the case firms.

The author argued in chapter 5 that there are two types of environmental factors that 'influence' payment systems in the case firms. One is where the case firms recognise the influence and the other is where the case firms do not recognise the influence. This seems to contradict the above categorisation where one type is those that the case firms pointed out, and the other is those that the case firms perceived but did not point out. In chapter 5, 'influence' by environmental factors included both types -- influence on the formation of a particular type of payment system long used in the case firms, and influence on changing the payment systems. The discussion of 'influence' here is limited to influencing change of the payment systems. This research found that the case firms recognise the influence on changing payment systems more than the influence on the formation of their long used payment systems. For the formation of their long used payment system, there are environmental factors that the case firms did not recognise at all, but for change forces, they at least recognised their existence, even though they did not point them out as reasons for their changes.

This thesis divides the type of environmental forces into two -- low context/contingency factors and high context/institutional factors, as discussed in chapter 4. The case firms directly pointed out the environmental change forces of low context/contingency factors as reasons for their changes. On the other hand, although they perceived them as many internal documents show, they did not mention the environmental change forces of high context/institutional factors as reasons for their changes in the interviews. One of the reasons for this may be the cognitive process or limitation of people, as discussed in chapters 4 and 5. Another reason may be that practitioners want to think that they make decision rationally (Mintzberg et al. 1999). Institutional theory assumes that people do not necessarily behave rationally. If practitioners point out institutional factors as change forces, they are admitting that their decisions are not necessarily rational. For example, it is difficult for HR practitioners to claim that the reason for changing their payment system is to follow trends. Although HR practitioners in the case firms may not consciously think this logically, they may act on a hunch.

Since the case firms are unlikely to directly point out high context/institutional factors, logical analysis is needed in order to specify the change forces in this category. List of factors indicated in table 4-1 'environmental factors in low context and high context

perspective' in chapter 4 was utilised for the analysis. Further, environmental factors listed in table 4-1 were generally utilised as potential change forces. Although the author did not ask to the case firms about each factor listed in table 4-1 as to whether or not it is change force, the author had in mind these factors during the research. For example, if the case firms mentioned related issues with the factors listed in table 4-1, the author asked situation of the environmental factors related to their discussion.

As discussed in chapter 4, contingency factors and institutional factors are not necessarily mutually exclusive. Many factors are included in both categories. The difference between them is how the environmental factors influence the behaviour of firms as well as characteristics of the environmental factors.

9.3 Low context/contingency environmental change forces in case study firms

We now investigate specific environmental change forces in the Japanese and UK case firms. It is noted that, while various environmental change forces were pointed out by the case firms (as will be indicated in tables 9-1 and 9-2), discussion on why and how these forces influence payment system change in the case firms is limited to several major forces. There are two selection criteria for the major factors discussed. The first is the selection of environmental forces that apply to most case firms in each country. The second is the selection of environmental change forces that have a close relationship. The second criterion is applied to the 'situation of market competition as increased competition' and to the 'change of market'. That is, market competition increased mainly due to a change of market, or the main direction of the market change is increasing market competition. Therefore, they are treated as one factor as 'change of product and service market towards increasing competition'.

9.3.1 Influence of low context/contingency change forces in the Japanese case firms

Firstly, environmental change forces in low context/contingency factor in the Japanese case firms are discussed. Table 9-1 summarised low context/contingency change forces in the Japanese case firms. The change forces listed in tables 9-1 are limited to environmental factors with proximate relationships to changes in payment systems.

Table 9-1: Low context/contingency environmental change forces in the Japanese case firms

Environmental change forces	Case firms whose payment systems have been changing through influence from environmental change forces
Low context/contingency factor	
External factors	
National economic situation – recession	Company JR1, JR2
Product and service markets	All case firms
(1) Situation of market competition – increased competition	All case firms (main market is Japanese domestic market for all case firms)
(2) Change of market	All case firms Company JT1, JT2, JT3 (especially strong)
(3) Position in an industrial sector on the global scale	Company JC1, JO1
Technology – change of technology	Company JT1, JT2, JT3
Labour market	Company JT1, JT2, JT3
Government policy – deregulation	Company JT1, JT2, JT3, JF2, JR1, JR2, JC1, JO1
Change of national economic position in the world economy	All case firms (but weak)
Internal factors	
Ownership structure	Most case firms
(1) Change in shareholder structure	Most case firms
(1-1) Decreasing stable shareholders and increasing foreign shareholders	Company JR1 (major exception as it is not listed company) Company JC1 and Company J2 (especially strong)
(1-2) Takeover by UK firms	Company JT1, JT3
(2) Shareholding by holding company	Company JT2
Trade union structure	Company JT2
Perspective and reaction of employees	All case firms
(1) Recruiting and retention aim	Company JT1, JT3
(2) Motivation aim	All case firms (but weak)
Financial results	Company JR1, JR2
Organisation strategy - change in type of organisation strategy	Most case firms – major exception is Company JR1, as it is not listed company.
HRM strategy	All case firms
(1) Reward policy	All case firms

(2) Strong link between organisation strategy and reward policy	Company JC1, JC2, JR1, JF1
(3) Change in employment policy	Company JC1, JC2, JR1, JF1

The environmental change forces discussed here are 'change of product and service market towards increasing market competition', 'government policy as deregulation', 'change of national economic position in the world economy' as external change forces, and 'ownership structure in terms of change in shareholder structure', 'perception and reaction of employees', 'organisation strategy' and 'HRM strategy' as internal change forces.

The first aspect is external contingency change forces. 'Change of product and service market towards increasing market competition', 'government policy as deregulation' and 'change of national economic position in the world economy' are examined in this category.

The first consideration is a change in the product and service market towards increasing market competition. There are several reasons for change of the markets, such as change in consumer behaviour, the progress of technology, change in the competitive situation due to mergers and acquisitions, and increased inward investment by overseas owned MNCs. Changes in the markets have led to changes in payment systems in the case firms in the following way. Changes in the markets decrease the importance of past experience. Young workers tend to have the skills required by new business areas. Therefore, changes in the markets decrease the necessity of seniority-related pay. Amongst the case firms, three telecom firms expressed rapid and radical market changes as the stronger change forces. According to these case firms, as the telecom market has been changing rapidly, the development of new business areas is a key issue for their survival. The difference in individual contribution becomes larger in such a situation. Furthermore, these market changes require changes in employee profiles to increase the status of employees with skills required by new business areas, and these employees tend to be young. Therefore, the market changes have been encouraging change in their payment systems to make larger pay differences through the assessment of individual contributions and the reduction of seniority elements.

Furthermore, market changes almost equates to increasing market competition in the

case firms. That is, the case firms consider market changes towards increasing market competition. In fact, all the reasons pointed out as reasons for the market change -- change in consumer behaviour, the progress of technology, change in the competitive situation due to mergers and acquisitions, and an increased inward investment by overseas owned MNCs -- are also the reasons for increasing market competition. Intensified market competition requires high quality, value-added products and services, and high productivity. At the same time, cost reduction is required. Selection and effective deployment of high contributors and the establishment of a performance culture are the keys to achieving market success. The effective use of personnel costs is also required within highly competitive markets. These requirements have been leading changes in payment systems to reduce seniority elements and increase appraisal-related pay. The main market is limited to the Japanese domestic market for most case firms. This is because of the characteristics of industrial sectors in Japan which were selected as case industries. Firms in Japan in the food and drink, chemical and pharmaceutical, retail and oil industries, which were selected as case industries, are relatively small and weak in competitive power when compared with large overseas-owned competitors. The telecom industry in the advanced countries is in a similar situation, as deregulation has been proceeding and this has increased market competition both globally and domestically. However, international presence of Japanese telecom firms is small.

The second external contingency force is the change of government policy on deregulation. This strongly influences the industrial sectors where government regulation or intervention was previously strong. Among the case firms, telecom, pharmaceutical, retail and oil firms are strongly influenced by deregulation in many areas, including payment systems. In the telecom industry, the deregulation policy is the common policy amongst advanced countries and it has increased competition on both the domestic and global scales. The achievement of high quality service for cheaper prices is now more required than in the past for the telecom firms due to increased competition. As seniority-related promotion and pay increases can decrease the competitive power of the telecom firms, they have been changing their payment systems. The purposes of regulations for retail, pharmaceutical and oil industries included the protection of small firms. Therefore, competition in these industries was decreased by regulations. As a result, firms in these sectors tend to be smaller and their competitive power tends to be weaker than that of large overseas-owned MNCs. As regulation has recently been relaxed in these industrial sectors, market competition has been increasing

among Japanese firms. In addition, as inward investment by large overseas-owned MNCs has increased through the deregulation, market competition has been further facilitated. Hence, deregulation policy has the same effect on increased market competition for the payment systems in these case firms. Thus, the change in government policy on deregulation encourages change towards an emphasis on individual contribution for individual pay determination mainly through a reduction in seniority-related pay.

The third external contingency force is the economic position of Japan in the world economy. While most case firms mentioned this factor as one of the reasons for their changes, according to their internal documents, no firms emphasised this factor in the interviews. Therefore, the author judged that this factor is a change force for all case firms, but its influence is weak. The change of the Japanese position in the world economy from catch-up to front runner has changed the Japanese economic growth rate. Japan cannot expect high economic growth as it has experienced in the past. As Japanese payment systems are suited to high economic growth, they must change to systems suited to low economic growth. No one denies this logic, and the case firms used this logic as the reason for their changes. But this factor concerns a general tendency of Japanese firms, and does not bring the concrete change to external and internal environmental factors of payment systems in the case firms. This may be why the case firms do not emphasise this factor. Another reason may be that concrete changes related to this factor in the case firms have already started, such as the change in types of organisation strategy, as will be discussed later.

The next aspect is internal contingency change forces. 'Ownership structure in terms of change of shareholder structure', 'perspective and reactions of employees', 'organisation strategy'¹²⁰ and 'HRM strategy' are examined in this category.

The first type of internal contingency force is ownership structure in terms of change in shareholder structure. There are two causes for the influence on payment systems by this force. One type is acquisition by the UK firms. Company JT1 and Company JT3 are so categorised. This change strongly and directly influences their payment systems (influence of the UK parent firm on the payment system in Company JT1 was

¹²⁰ This thesis uses the term 'organisation strategy' to include both corporate and business strategies. Functional strategy, except HRM strategy, is also included within organisation strategy, as indicated in chapter 4

illustrated in section 6.6 in chapter 6). However, as this thesis limits the subject to Japanese-owned firms in Japan, the content of this influence is not focused upon. The reason for the inclusion of Company JT3 was discussed in chapter 5, and Company JT1 became a subsidiary of the UK firm during the process of the case study.

The other type of ownership structure is a change of shareholder structure towards decreasing stable shareholders and increasing foreign shareholders. As the case firms generally consider that stable shareholding will decrease, they realise that individual shareholders and/or agency shareholders with no business relationship have become more important. In particular, foreign investors become more important, because they have been increasing their shareholding more than Japanese individual and agency shareholders, and they are active shareholders such that their influence on share prices is larger than the proportion of their shareholdings would suggest¹²¹. Changing the shareholder structure more or less influences payment systems through changing the organisation strategy for most case firms¹²². In particular, as Company JC1 (30.1% as of 31st Sep. 2002) and Company JC2 (35.4% as of 31st Sep. 2002) have large proportions of foreign shareholders, they particularly emphasise shareholder value, and this has been encouraging changes in their payment systems.

The change in shareholder structure encourages changes in the payment system such as creating a direct link between organisational performance such as overall company performance and divisional performance, and individual pay levels, and increasing emphasis on individual contributions, especially output performance for individual pay determination.

The second internal contingency factor is 'the perception and reactions of employees'. This factor mainly concerns two aspects -- recruitment and retention, and motivation. Company JT1 and Company JT3 pointed out that the recruitment and retention of valuable workers was the most important reason for changing their payment systems. Directions taken by this force is a decrease in seniority-related pay and an increase in consistency between individual contribution and pay levels. All case firms pointed out the motivation of valuable employees as a reason for changing their payment systems, but motivation is just one of the reasons and not the most emphasised one. This is

¹²¹ Proportion of amounts of bargaining shares (in terms of monetary value) by foreign investors was 52% in 2001 (Nippon Keizai Newspaper 2001).

¹²² The major exception is Company JR1 as it is not listed company.

different from recruitment and retention reasons which was emphasised as the most important reason. From the difference above, it is assumed that the recruitment and retention problem is more urgent and important than motivation.

The third internal contingency factor is organisation strategy. Whilst the degree and aspects of changes in organisation strategy differ amongst the case firms, there are some general trends such as increased emphasis on profit, the shift from credit-based finance to a mixture of credit-based and capital-based finance, the emphasis on shareholder value and the establishment of new types of corporate governance structure. Many case firms include these four aspects into their organisation strategies as important agenda¹²³, but the degree of emphasis on each aspect differs amongst the firms. The reasons why the case firms have been changing their organisation strategies are briefly described below. The reasons for the four aspects are inter-related.

The first aspect is 'increased emphasis on profit'. Japanese firms are often characterised by their strong emphasis on revenue, including their market share, and less emphasis on profit (Whitley 1992a, 1992b, Kaplan 1997, Kester 1996, 1997). But the case firms emphasise both revenue and profit. The main reason is that the failure of many firms following the collapse of bubble economy was linked to business expansion with less emphasis on profits. Once business expansion decreased, these firms had serious financial problems. This is a popular view in Japan after the collapse of the bubble economy and interviewees in the case firms cited this view as the reason why they currently emphasise profits. The change in shareholder structure is also a reason for the emphasis on profits. The case firms set various financial measurements to measure profits such as ROE (Return on Equity), EVA (Economic Value Added), and profit after tax and dividend payout ratio.

The second aspect is 'the shift from credit-based finance to a mixture of credit-based and capital-based finance'. This change is for the same reason as 'emphasis on profit'. The largest cause of financial difficulties in firms after the collapse of the bubble economy was investment through bank loans. Now the case firms realise that this is risky if the investment does not bring a return.

¹²³ The major exception is Company JR1. As it is not listed company, change of financial system and shareholder structure are limited.

The third aspect is 'emphasis on shareholder value'. This aspect is necessary once the case firms focus more on capital-based finance and shareholder structure changes towards reduction of stable/cross shareholding. Japanese firms did not have to emphasise profit and shareholder value under bank and stable/cross shareholding systems, but solid bank and stable/cross shareholding systems have been gradually changing in the case firms. As a consequence, profit and shareholder value have become more important.

The fourth aspect is 'the change in corporate governance structure'. This is necessary if factors that support corporate governance structure change. Japanese corporate governance structure is characterised by an insider system. This is supported by credit-based finance and cross shareholding systems. Now that these factors have been gradually changing in the case firms, changes to the corporate governance structure are required. The case firms (Company JT1, Company JT2, Company JF1, Company JF2, Company JC1 and Company JC2) announced in their IR (Investor Relations) information the establishment of new corporate governance structures, such as the introduction of holding companies or internal company (*shanai bunsha*) structures, the introduction of reward systems explicitly linked to shareholder value such as share options, and changes to board member structure. Changes to board member structure include a reduction in the number of board members, the introduction of a non-executive director, a strengthening audit function and the introduction of committees such as an appointment committee for board members and a remuneration committee. The reasons for these changes include the change in corporate law in 2003.

Changes in organisation strategy encourage changes in payment systems towards an emphasis on individual contribution, especially output performance for individual pay determination, mainly through decreasing seniority-related pay, increased link between appraisal and pay, and a direct link between organisational performance (overall company performance and divisional performance) and individual pay.

The sixth internal change force is HRM strategy. HRM strategy strongly influences changes in payment systems in all case firms. As payment systems are just one area of the HRM system, direct and strong links between HRM strategy and payment systems may be natural. This is consistent with the notion of internal fit or the configuration perspective of HRM theory. Three areas within HRM strategy have been particularly

encouraging changes in payment systems.

The first aspect of HRM strategy is the change of reward policy. The author translated '*shoguu*' used in the case firms as 'reward' in English. However, content of *shoguu* and content of reward are not equivalent. *Shoguu* includes only extrinsic reward and it usually means promotion and pay. Therefore, although this thesis use word 'reward', the reward includes only extrinsic reward especially promotion and pay. All case firms have been changing their reward policies to reduce the seniority elements and increase the influence of individual contribution. As reward policy is the most proximate environmental factor, the change of the reward policy has most directly and strongly been directing the changes in payment systems in the case firms. Alternatively, since pay is one area of reward, a change of reward policy may not be considered on environmental factor, but the principle level of payment systems. That is, the reward principle is a part of the payment system, not located in an environment outside of the payment systems.

The second is the strong link between organisation strategy and reward policies. The case studies found that the degree of change to reward policies is related to the link between organisation strategy and reward policies in the case firms. That is to say, the case firms with a strong link between organisation strategy and reward policies have been changing their payment systems more than other case firms. This thesis uses criterion concerning whether or not the statement of organisation strategy in the IR information considers reward policies as important strategic agendum, in order to decide whether the case firms have strong links between organisation strategy and reward policies. Company JF1, Company JC1 and Company JC2 state reward policies as the main strategic agenda in their statements. Company JT1 also states reward policies in their statement, after the appointment of a new CEO by the UK parent firm. However, concrete action based on the policy of the new CEO did not start during the period of the case study. Therefore, Company JT1 is excluded from the strong link examination. Company JR1 is added to the firms that have a strong link between organisation strategy and reward policies as result of the research¹²⁴. When the former CEO was appointed to the position of CEO, Company JR1 was facing bankruptcy. The former CEO set the change of reward policies as one of the main strategies for corporate restructuring and

¹²⁴ As Company JR1 is not a listed company, the shareholders statement is not released to the public.

he initiated this change. The current CEO of Company JR1 was the head of HR when Company JR1 changed its reward system¹²⁵. By these facts, the author judged that Company JR1 has made a strong link between organisation strategy and reward policies.

The third aspect is the change in employment policy so that there is less emphasis on long term employment. All case firms introduced *kibou taishoku* (voluntary turnover) programmes and more or less changed the employment policy to reduce the employees covered by long term employment.

For example, Company JO1 introduced the *kibou taishoku* (voluntary turnover) programme after Company JO1 was established through a merger between the former largest oil firm and the former sixth ranked oil firm in 1999. The three main reasons for this introduction are as follows.

The first is to avoid decreasing organisational efficiency and effectiveness by prevention of demotivation among high contributors, especially young high contributors. Company JO1 thinks that the past HR practices in the two former firms were too seniority-related. As a result, many old and middle aged employees have high qualification grades (*shokunou shikaku toukyu*) and high pay levels but are low contributors. Company JO1 thinks that this is a problem because it can decrease motivation among other employees, especially young employees who are high contributors and whose qualification grade and pay levels tend to be low under the seniority-related qualification grade promotion and pay increase practices. Company JO1 introduced two methods to deal with these old and middle aged low contributors. One is the introduction of qualification grade demotion associated pay decreases as discussed in section 6.4.5 in chapter 6. The other method is the introduction of the voluntary turnover programme, and Company JO1 encourages these low contributors to apply to the voluntary turnover programme.

The reason for the introduction of the voluntary turnover (*kibou taishoku*) programme is that these old and middle aged low contributors are unlikely to increase job-related abilities. Therefore, even though Company JO1 continues to employ these people, the firms cannot gain benefits from them. Furthermore, these employees may be

¹²⁵ The former CEO was appointed as the CEO of a bankrupt department store to rebuild the department store, but he returned to the position of the CEO of Company JR1 on June 2003 in order to rescue it from a bad financial situation.

demotivated by their qualification grade demotion and pay decreases. In addition, although the number of employees whose qualification grade was demoted was small (at the time of the research in 2000) at about 50 employees, many other low contributors may know their career opportunities in Company JO1 are low and they may understand that their qualification grade and pay level may be decreased in the future. This is because Company JO1 had already sent messages about its judgment of their low contributions through low appraisal ratings and line managers' comments. The existence of demotivated employees can have a bad effect on other employees. This reason is the most important one for the introduction of the voluntary turnover programme.

The second reason is decreasing personnel costs by a reduction in head count. However, this is a minor reason because pay costs against total costs and sales revenue is small in Company JO1. This is a general tendency in the oil industry.

The third reason is that it is better for old and middle aged employees judged as being low contributors by Company JO1 to seek career opportunities in other firms. This is because, although they are judged as being low contributors with low career opportunities in Company JO1, their career opportunities in other firms may be higher than in Company JO1.

However, the degree of the change differs among the case firms. In some case firms, there are no clear changes in employment policy in terms of long term employment. For example, Company JO1 introduced the voluntary turnover programme. However, it did not change its employment policy as applied to the majority of employees (or the principle of employment policy) towards decreasing long term employment. According to interviewees in Company JO1, the main reason for this is that the CEO of the firm and its management team do not change its employment policy clearly, although they recognise that long term employment applied to the majority of employees will probably change in the future. Now the Company JO1 treats employees who leave Company JO1 in the mid career as exceptions.

The author found that there is a correlation between the extent of change in long term employment policies and the extent of change in payment systems by comparing the Japanese case firms. That is, if the case firms change their employment policy more widely and clearly, they change their payment systems to a larger extent. Amongst the

case firms, Company JR1, Company JC1 and Company JC2 have changed their employment policies more clearly and they have explicitly announced this change to their employees. For example, corporate HR in Company JR1 created an employee hand book that explained new employment policy and the new type of career development, and delivered this to employees. The new type of career development in Company JR1 means more of an independent type of career development, whereas the old type of career development was more dependent on the firm and meant that employees lost other career options outside the firm, once they entered the firm. Furthermore, Company JR1 positively announces that working for Company JR1 is one option for employees among various career options, and it encourages employees to develop skills and knowledge career applied to other firms. Moreover, Company JR1 holds workshops to explain the new employment policy and the development of individual career plans as the new type of career, and how to utilise voluntary turnover programme.

As all case firms realise the importance of long term employment, no case firms deny long term employment. Change in employment policies means reducing a particular type of long term employment which spread in post-war Japan. That is, long term employment from graduate recruitment to retirement applied to most *seishain* (full-time and permanent employee) as a presupposition of employment regardless of organisational financial results and individual contributions. The three firms decided upon and announced the abolition of this type of long term employment (this thesis calls this type of long term employment 'lifetime employment' as discussed in chapter 3). As the three firms do not deny long term employment, they claim that long term employment from graduate recruitment to retirement can occur, but it is a result rather than a presupposition of employment. Both firms and employees can reserve the right to quit or remain with the firms. Individual employees are encouraged to make their career by themselves and not by relying on the firms. Company JR1 and Company JC1 have strong intentions to reduce the number of their employees in order to reduce their personnel costs. Company JC2 does not have this strong intention, but it considers that a change in employee profiles is necessary, according to the changes in their organisation strategy.

Company JF1 is also changing its employment policy, since one of the main purposes for changing their HRM system is the establishment of a system which will be suited to

the increased labour mobility between firms. Therefore, the direction of employment policy in Company JF1 is considered to be a reduction of long term employment. However, Company JF1 did not clearly decide on the reduction of long term employment and a change in the relationship between the firm and individuals. Therefore, Company JF1 changed its employment policy but to a lesser extent than the above three case firms. Other case firms did not clearly change their employment policies and did not clearly establish HRM systems to facilitate changes to their employment policies, although they perceive that long term employment will be reduced in the future as indicated above using an example of Company JO1. In fact, they actually reduce the extent of long term employment through the implementation of a voluntary turnover programme.

9.3.2 Influence of low context/contingency change forces in the UK case firms

Next is examination for the UK case firms. Low context/contingency change forces in the UK case firms are summarised in table 9-2. The change forces indicated in table 9-2 are limited to proximate relationships with change in payment systems as same as the Japanese case firms.

Table 9-2: Low context/contingency environmental change forces in the UK case firms

Environmental change forces	Case firms whose payment systems have been changing through influence from environmental change forces
Low context/contingency factor	
External factor	
Product and service markets	All case firms
(1) Situation of market competition – increased competition	All case firms (both global and domestic scales)
(2) Degree of market growth	Company BT1 through decrease of market growth Company BF1, BF2 through low market growth
(3) Change of market	All case firms Company BT1, BT2 (especially strong)
(4) Position in an industrial sector on the domestic and global scales	Company BF1
Technology	Company BT1, BT2 through rapid and radical

	change in technology Company BF1, BF2 through little technological breakthrough in developing new markets
Labour market	Company BT1, BT2, BF1, BF2, BR1, BC1
Government policy – deregulation	Company BT2
Internal factors	
Organisation strategy	Company BF1, BF2, BF3
Perception and reactions of employees	All case firms
HRM strategy	All case firms
(1) Reward policies	All case firms

Low context/contingency change forces discussed for the UK case firms are ‘change of product and service market towards increasing market competition’, ‘labour market situations’ as external forces, and ‘perception and reaction of employees’ and ‘HRM strategy’ as internal forces.

The first external change forces analysed is change in product and service market towards increasing market competition. All case firms mentioned the change in markets as a change force. There are various reasons for this market change such as changes in consumer behaviour and changes in the competitive situation due to mergers and acquisitions, and technological progress. Amongst the case firms, rapid and radical market changes particularly encouraged changes to the payment systems in Company BT1 and Company BT2. In the two firms, jobs are reviewed every 6 to 12 months, since jobs within the organisations change quickly and many new jobs are created within a short period. This situation has changed job evaluation methods and pay structures to more flexible types.

The most striking result of changes in the market is increasing market competition in the UK case firms just as same in the Japanese case firms. All case firms mentioned that increased competition in markets has been leading changes in their payment systems. The product and service markets of all the UK case firms include both global and domestic markets, as all UK case firms do business on a global scale, while all Japanese case firms mainly do business in the Japanese domestic market. There are two main directions of change in payment systems due to increased market competition. One is the introduction of market driven pay determination. Pay tends to increase according to years of service, even though job and contribution levels do not change. The case firms

cannot afford pay drift with increased market competition and market driven pay determination can prevent this. Company BT1, Company BT2, Company BF1, Company BF2, Company BR1 and Company BC1 implemented market driven pay determination. The other direction is the strengthening of the link between individual contributions and pay. Generally IPRP (individual performance-related pay) has been the focus since the mid 1980s in the UK. As Company BT1, Company BR1 and Company BF1 have recently implemented formal performance management systems relating to pay across their organisations, all case firms now operate performance management systems linked to pay. Performance culture is considered necessary with increased market competition and the case firms expect the operation of IPRP to encourage the performance culture. Furthermore, the need for recruitment, retention and motivation of valuable employees has become more important with increased market competition. 'Pay for contribution' is necessary.

The second external contingency factor is the labour market. The UK case firms are generally more sensitive to the labour market situation than the Japanese case firms, and they have been changing their payment systems to align with the labour market situation. Concrete changes to align with labour markets are the introduction of market driven pay determination and job family pay structures. Company BT1, Company BT2, Company BF1, Company BF2, Company BR1 and Company BC1 introduced market driven pay determination. Company BT1, Company BF1, and Company BC1 introduced a job family pay structure, and Company BT1 and Company BF2 implemented job family pay structures, although they are informal.

The next examination is internal contingency change forces. The first internal contingency factor is the perception and reactions of employees. All UK case firms consider this in the design of their payment systems. For example, one of the reasons for introducing job family pay structure is to align an employee's career aspirations to the payment systems. As UK employees tend to have career aspirations within one function, the job family pay structure is suited to this type of career aspiration. The main reason for considering the perception and reactions of employees is the recruitment and retention of valuable workers.

The consideration of the perceptions and reactions of employees in the UK case firms in the design of their payment systems seems to be stronger than in the Japanese case firms.

The reason for this may be the degree of strength for recruiting and retention purposes. Japanese case firms little consider the recruitment and retention of workers in the design of their payment systems, with the exception of the two telecom firms which have been under the spread of long term employment in Japan. All Japanese case firms mentioned motivation of valuable employees as a reason for changing their payment systems. But their consideration for the reactions and perception of employees seems to be lower than the UK case firms, except in the two telecom firms. Recruitment, retention and motivation are generally considered as the basic purposes of pay. Amongst these, recruitment and retention have more recognisable and immediate effects than motivation. Firms tend to consider the reactions and perceptions of their employees more if they have recruitment and retention aims rather than just having a motivation aim, according to a comparison between the case firms in the UK and Japan and between Japanese case firms.

The second internal contingency factor is HRM strategy. HRM strategy changes payment systems in various ways. For instance, Company BF1 set three agenda in HRM strategy in order to achieve its organisation strategy, and it has been changing its payment systems to achieve this HRM strategy.

Within the HRM strategy, reward policies are the strongest change forces, just as they are in the Japanese case firms. As indicated in chapter 2, the types of reward are largely divided between extrinsic and intrinsic rewards. The reward policies discussed within the case firms emphasise extrinsic rewards, especially word 'reward' in the case firms almost equates financial reward. Whereas there are various reward policies in the UK case firms, their common policy is the strengthening of the link between reward and output performance or contribution. This policy has changed payment systems in various ways, such as changing job evaluation methods and pay structures. Furthermore, the majority of the case firms changed their focal point from internal relativity to external relativity. As a result, market driven pay determination and broadly and loosely banded pay structures were introduced. Alternatively, reward policies may not be environmental factors but the principle of payment systems is the same as in the Japanese case firms.

9.4 High context/institutional environmental change forces in case study firms

The next consideration is high context/institutional change forces. These forces for Japanese case firms and UK case firms are summarised in tables 9-3 and 9-4.

Table 9-3: High context/institutional environmental change forces in the Japanese case firms

High context/institutional factor	
General trends in HRM and payment systems	All case firms
General trends in changes in type of organisation strategy	Most case firms – major exception is Company JR1, as it is not a listed company.
Change in proximate social institutions and business systems	Most case firms – major exception is Company JR1, as it is not a listed company.

Table 9-4: High context/institutional environmental change forces in the UK case firms

High context/institutional factors	
General trends in HRM and payment systems	All case firms

Whilst how and why low context/contingency factors encourage change in payment systems in the case firms are analysed for each country: firstly the Japanese case firms were discussed and secondly the UK case firms were discussed, order of the analysis changes for high context/institutional factors by order of each context/institutional factor.

The reason for this change is to make the flow of discussion more effective. For example, the author analyses how ‘general trends in HRM and payment systems’, which is one of the high/context contingency change forces, diffuses among the case firms and compares differences in diffusion mechanisms between Japan and the UK. More importantly, two change forces -- ‘general trends in changes in type of organisation strategy’ and ‘changes in proximate social institutions and business system’ -- exist in Japan, but the author did not find these forces for the UK. Therefore, only the Japanese situation is analysed for these two forces, and the author discusses why the difference occurred between Japan and the UK. The discussion leads to the causes of the difference for the extent of change in payment systems between Japan and the UK: the extent of

change is larger in Japan than in the UK. Hence, analysis for each change force is more effective.

Environmental forces considered are ‘general trends in HRM and payment systems’, ‘general trends in changes in type of organisation strategy’ and ‘changes in proximate social institutions and business system’. For ‘general trends in changes in type of organisation strategy’ and ‘changes in proximate social institutions and business system’, only the Japanese case firms are the subject of the discussion. The reason for this will be mentioned in the analysis of these factors.

9.4.1 General trends in changes in HRM and payment systems

(1) Japanese case study firms

The diffusion of trends is one of the mechanisms of institutional isomorphism as a mimetic process (DiMaggio and Powell 1983). Although trends in payment systems were not pointed out by the case firms as change forces, the author found evidence through the interviews with the case firms and internal documents of the case firms, that these trends actually have influenced changes in payment systems. For instance, HR practitioners and other employee interviewed often said that the payment systems in their firms have been changing under the trend towards more emphasis on individual contribution. Various internal documents also showed that the case firms have perceived the trends in HRM and payment systems. While it is certain that perceived trends have been facilitating changes to their payment systems, how the perceived trend has influenced the payment systems in the case firms is complicated. There may be some internal facilitators in the case firms. Three types of facilitator can be considered based on the findings of this research -- top management, HR practitioners and employees.

The first type of facilitator is top management. HR practitioners interviewed often gave the reason for changes to payment systems as the order of top management. Whilst there are various orders from top management, the case firms shared the direction of contribution-based HRM or payment systems (*jitsuryoku shugi jinji* or *chingin*)¹²⁶. The

¹²⁶ The author translated word ‘*jitsuryoku shugi jinji*’ as contribution-based HRM in English, although meaning of *jitsuryoku* is more equivalent to such as merit or ability. This is because *jitsuryoku shugi jinji* generally includes *nouryoku shugi jinji* (ability-based HRM) that emphasis on input aspect of person factor and *seika shugi jinji* (output performance-based HRM), and

top management gathers information about general trends or practices of other firms through such resources as media, communication with top managers in other firms and information from professionals. They suggest HR practitioners to study the trends. For instance, the CEO of Company JO1 suggested benchmarking the output performance-based payment system of other firms. The author assumes the following points on reason why top management is interested in these trends. As many firms share external environmental factors, top management may think that changing in the same direction will bring good results. Furthermore, many theoretical supports are developed by professionals about current trends. Top management is likely to be convinced by these theoretical supports. Thus, the trends tend to diffuse. This mechanism is considered as the mimetic process of institutional isomorphism (DiMaggio and Powell 1983), although top management is unlikely to simply copy other firms' practices. Rather, they are convinced by the logic of the trends.

The second type of facilitator is HR practitioners. HR practitioners are strongly interested in trends and gather the information about them. They are asked to design new payment systems by top management. They also propose the necessity of change to payment systems and design new ones. In the latter case, the reasons may be as same as those given for the top management. That is, they are likely to be convinced by the theoretical support about trends and tend to think that implementation of these trends may bring good results. The other reason is the difficulty of rejecting trends. Changing payment systems in the direction of trends is more likely to get support from various coalition groups within organisations, such as top management and other employees, than a change in the opposite direction or no change at all. Furthermore, changing the payment system can demonstrate an achievement by the HR practitioners. It is a benefit for HR practitioners.

The third type of facilitator is employees other than those in the HR practitioners. Employees gather information about trends in various ways, such as media and communication with various types of people. Employee groups who benefit from changes according to trends may support that change. Employee groups who are disadvantaged by changes according to trends may not positively support them. However, their resistance may be smaller than that for a change not consistent with

trends, because they may realise that it is difficult to resist trends.

(2) UK case study firms

Changing payment systems in the UK case firms can be also influenced by recent trends of HRM and payment systems as same as the Japanese case firms. In fact, various internal documents theorise on the underpinnings of recent trends in HRM and payment systems. As far as directions of the trends are concerned, they have some similarities with the 'new pay' proposed by Lawler (1990), and Schuster and Zingheim (1992), such as the emphasis on external relativity and person factors, although the changes in the case firms are less radical than this. Long term trends such as the emphasis on individual contribution for pay determination have also influenced payment systems in the UK case firms. Influence by trends is similar to that in the Japanese case firms.

This thesis emphasised the role of top management for introduction of HRM and payment system trends in the Japanese case firms. The support or positive role of top management is needed in the Japanese case firms, because the extent of change in payment systems is largely associated with the basic characteristics. On the other hand, there is little change in the basic characteristics on the UK side. Therefore, changes in payment systems do not necessarily need the support of top management, because employee resistance to the change may be small. In the UK case firms, HR practitioners may be the main facilitators for implementing trends and top management can be positive or passive supporters.

9.4.2 General trends in changes in type of organisation strategy

(1) Japanese case study firms

The second high context/institutional factor is 'general trends in changes in type of organisation strategy'. As pointed out in 'low context/contingency factor', organisation strategy is changing in the Japanese case firms. It is certain that the case firms change their organisation strategy in order to compete in their product and service markets. Therefore, the change in organisation strategy is categorised as a low context/contingency factor. Nonetheless, there are questions as to why most case firms change their organisation strategies in similar directions and why they use similar logic

for these changes. One possibility is the adaptation to general trends and recently popular logic. In fact, various survey data show changes in organisation strategies in Japan. The case firms have shifted strategies in line with the general directions. In this sense, the reason for changing organisation strategies in the case firms can be categorised as a high context/institutional factor. The mechanism for adopting trends of organisation strategy may be the same as the mechanism for general trends in HRM and payment systems. Top management gathers information on recent trends and logic that supports the trends in various ways. Popular logic may also be more acceptable to stakeholders such as shareholders and employees, since they may know the trends and logic. Hence, this mechanism is considered to be mimetic isomorphism in the same way as recent trends in HRM and payment systems. Coercive isomorphism also functions in changes in organisation strategy, because reasons for these changes include adaptation for new regulations, such as changes in corporate law and financial statement.

The discussion for this force is limited to the Japanese case firms and excludes the UK case firms for three reasons. The first is that all of the Japanese case firms changed their organisation strategy and the change encouraged changes in their payment systems, although the degree of the organisation strategy changes and the degree of the link differed among the case firms. The author also found a relationship between changes in organisation strategy and changes in payment systems in three UK case firms; Company BF1, Company BF2 and Company BF3. These three case firms have been changing their organisation strategy towards focusing on core businesses and divesting themselves of other businesses identified as non-core businesses, and this change encourages changes in the payment systems of these case firms. However, the author could not find a clear relationship between changes in organisation strategy and payment systems in other UK case firms¹²⁷. The UK case firms changed their payment systems due to other forces, such as a change of product and service market and adaptation to the labour market, rather than due to changes in organisation strategy. In other words, the link between changes in organisational strategy and changes in payment systems is generally weaker in the UK case firms than the Japanese case firms.

Secondly, although most UK case firms have been changing their organisation strategy

¹²⁷ As described in section 7.5 in chapter 7, Company BT2 established reward elements globally applied to Company BT2 group firms in relation with change of the organisation strategy. However, payment system in the UK is little direct relationship with change in the organisation strategy.

in various directions, these changes however are not related to changes in the national characteristics of proximate social institutions and business systems discussed in chapter 4. In contrast, changes in organisation strategy in Japanese case firms are related to changes in national characteristics. This thesis focuses on the relationship between national characteristics such as economic structure and social institutions in the analysis of payment system changes, and also points out six factors as having a particularly strong influence on the formation of the national characteristics in employment and payment systems in chapter 4. Therefore, changes in organisational strategy related to these aspects are more critical in the analysis of changes of payment systems. The Japanese case firms have been changing their organisation strategy in relation to national characteristics of proximate social institutions and business systems. However changes in organisation strategy in the UK case firms are not related to these factors. For example, focusing on core business and withdrawing from non-core business may be one of the directions taken by the UK case firms. This change is not related to changes in the national characteristics of economic structure and social institutions discussed in chapter 4. Although diversification into unrelated areas is one of the characteristics in UK business in comparison with Japanese business as pointed out in chapter 4, this characteristic may be a consequence derived from the national characteristics of economic structure and social institutions, not the cause of the formation of national characteristics in economic structure and social institutions.

Thirdly, in order that 'general trends in changes in type of organisation strategy' influence the case firms, organisation strategy related to national characteristics in areas such as economic structure and social institutions must change as general trends in one country. However, there is little evidence that shows large changes in types of organisation strategy associated with the national characteristics in economic structure and social institutions as being a general trend in the UK.

To summarise the three points; firstly, the link between changes in organisation strategy and changes in payment systems is generally weaker in the UK case firms than the Japanese case firms. Secondly, changes in organisation strategy in the UK case firms are not associated with changes in the national characteristics in economic structure and social institutions, and thirdly, there is little evidence to show large changes in the types of organisation strategy associated with national characteristics in economic structure and social institutions as general trends in the UK firms. For these reasons, the UK case

firms are excluded from the discussion.

9.4.3 Change in proximate social institutions and business systems

(1) Japanese case study firms

The third factor is 'change in proximate social institutions and business system'. This factor is related to the second factor. That is to say, changes in types of organisation strategy as general trends in a society can be regarded as changes to the business system of the society. This is because if the characteristics of strategy in one society are considered, they are the characteristics of business systems in the society, and if characteristics of strategy in each firm are considered, they are the characteristics of organisation strategy in that firm. The difference between them is the level of analysis at either the social level or individual firm level. Furthermore, the focal points are different between them. If the strategy of individual firms is considered, it tends to focus on the technological environment such as markets and technology, and if business systems in a society are considered, it tends to focus more on the institutional environment such as history, values and customs.

Therefore, as the type of organisation strategy in Japanese firms is generally changing, the characteristics of business system in Japan are considered to be changing. In fact, shareholder structure and corporate governance structure have been changing in Japan (NLI Research Institute 2002, Zenkoku Shouken Torihikisho Kyougikai 2002, Japan Investor Relations Association 2000, 2002, Japan Institute of Labour 1999, Japan Association of Corporate Executives 1999). These are two out of the three factors in business systems¹²⁸ for which this thesis argued the strong relationships with payment systems in chapter 4. Furthermore, financial systems, which is one of the three factors in proximate social institutions¹²⁹ for which this thesis also discussed the strong relationships with payment systems in chapter 4, has also been changing in Japan (NLI Research Institute 2002, Zenkoku Shouken Torihikisho Kyougikai 2002, Ministry of Finance 2001). Therefore, changes in proximate social institutions and business systems are also change forces for payment systems in the case firms. The content of change in proximate social institutions and business systems in Japan will be discussed later.

¹²⁸ The other factor is the work system.

¹²⁹ Other two factors are 'role of government', and 'education and vocational training systems and the importance of the skill certification system'.

The UK case firms are also excluded from the discussion of those forces for the same reasons that they were excluded from discussion of the second forces of 'general trends in changes in type of organisation strategy'. In other words, there is little evidence to show large changes in proximate institution and business systems with a strong influence on the formation of national characteristics for employment and payment systems.

9.5 External environmental forces for change that differentiate the extent of change

The previous chapter identified that the basic characteristics of payment systems in the Japanese case firms are changing. But there has been little change in terms of the basic characteristics identified by this thesis in the UK case firms, although the research found evidence of changes within the same basic characteristics such as changes in job evaluation methods and changes in pay structures in the UK case firms. Therefore, the thesis examines the reasons why the extent of change differs between the Japanese case firms and the UK case firms from the relationships between external and internal environmental factors, and changes in payment systems. A specific method used for the examination is a comparison of environmental change forces discussed above between the Japanese case firms and the UK case firms. The comparison is based on the assumption that environmental forces found only for the Japanese case firms may be environmental change forces that differentiated the extent of change in payment systems between the case firms in Japan and the UK. In terms of the environmental change forces, only the forces pointed out by all or most case firms in each country are compared; change forces pointed out by only a few case firms are excluded because these forces may be specific factors in each firm and/or each industrial sector (although there are little recognisable differences according to industrial sectors for change stages in payment systems in both Japan and the UK, environmental change forces pointed out by the case firms differ according to industrial sector as indicated in tables 9-1 and 9-2). External and internal change forces for case firms in either Japan or the UK are pointed out below.

Case firms in Japan

External change forces

- ☐ Change in the market towards increasing market competition
- ☐ Change to the national economic position in the world economy
- ③ Change of proximate social institutions and business systems
- ④ General trends in changes in type of organisation strategy
- ⑤ General trends in HRM and payment systems

Internal change forces

- ☐ Change in types of organisation strategy
- ② Perception and reactions of employees
- ③ Change in reward policy

‘Change of proximate social institutions and business system’ and ‘general trends in change in type of organisation strategy’ among external change forces and ‘change in types of organisation strategy’ have limited influence to Company JR1, since it is not listed company. The main change aspects concerning the three factors are financial system, shareholder structure and corporate governance structure. Therefore, the influence of these factors is weak for non-listed companies, although Company JR1 strongly emphasises profit (this aspect is one of the change in type of organisation strategy). Hence, these three factors are not change force for all Japanese case firms. However, as most large firms are listed company, Company JR1 is considered as exception.

When considering ‘general trends in changes in type of organisation strategy’ and ‘change of proximate social institutions and business systems’, the author argued in section 9.4.3 that a change in organisation strategy as a general trend in a society can be regarded as a change in the business system of that society. The differences between them are the level of analysis -- whether it is at a social level or an individual firm level, and whether there is focus on technological factors or institutional factors. However, ‘general trends in changes in types of organisation strategy’ and ‘proximate social institutions and business systems’ are treated as different factors because social institutions are different from organisation strategy. Social institutions are formed outside firms and business systems are formed as the collective characteristics of a firm’s behaviour in a society. Yet the two factors are closely related to each other and

the distinction between them is not clear cut, in particular in some aspects such as financial systems.

Case firms in the UK

External change forces

- ① Change in the market towards increasing market competition
- ② General trends in HRM and payment systems

Internal change forces

- ① Perception and reactions of employees
- ② Change in reward policy

Amongst the external and internal change forces, only change forces found on the Japanese side may differentiate the extent of changes between the two sides. The following change forces are those that worked only in the Japanese firms 'change to the national economic position in the world economy', 'change of proximate social institutions and business systems', 'general trends in changes in type of organisation strategy' (external factors), 'general trends in change in type of organisation strategy' (internal factor).

The three external change forces may lead to unleashing of the internal force. Furthermore, amongst the external forces, changes to the national economic position in the world economy from catch-up to front runner may be an original cause. This change has initiated a change in the three factors -- financial systems, shareholder structure and corporate governance structure -- pointed out as the change factors in proximate social institutions and business systems. This has encouraged a change in the type of organisation strategy in Japanese case firms, and Japanese firms in general. Alternatively, changes in the type of organisation strategy in Japanese firms in general have been commonplace in business systems in Japan in recent years.

As shown in sections 9.3 and 9.4, the degree of change in organisation strategy in the Japanese case firms is larger than in the UK case firms. The Japanese case firms are changing their organisation strategy in relation to the national characteristics of the Japanese economic structure or business systems. However, no such changes were seen in the UK case firms.

Furthermore, the link between organisation strategy and reward policy and emphasis on HRM strategy tend to be stronger in the Japanese case firms than the UK ones. Firstly, the link between organisation strategy and reward policy are considered. The degree of link between organisation strategy and reward policy for individual case firms is judged by whether the reward policies are included as an important strategic agenda in the statement of IR (Investor Relations) information. As a result, the author found that four Japanese case firms stated reward policies as the main strategic agenda in their statements as indicated in section 9.3.1. In contrast, there are no UK case firms that state reward policies as the main strategic agenda in their statements. No UK case firm focused particularly on reward policies and they treated the overall HRM area as one strategic area.

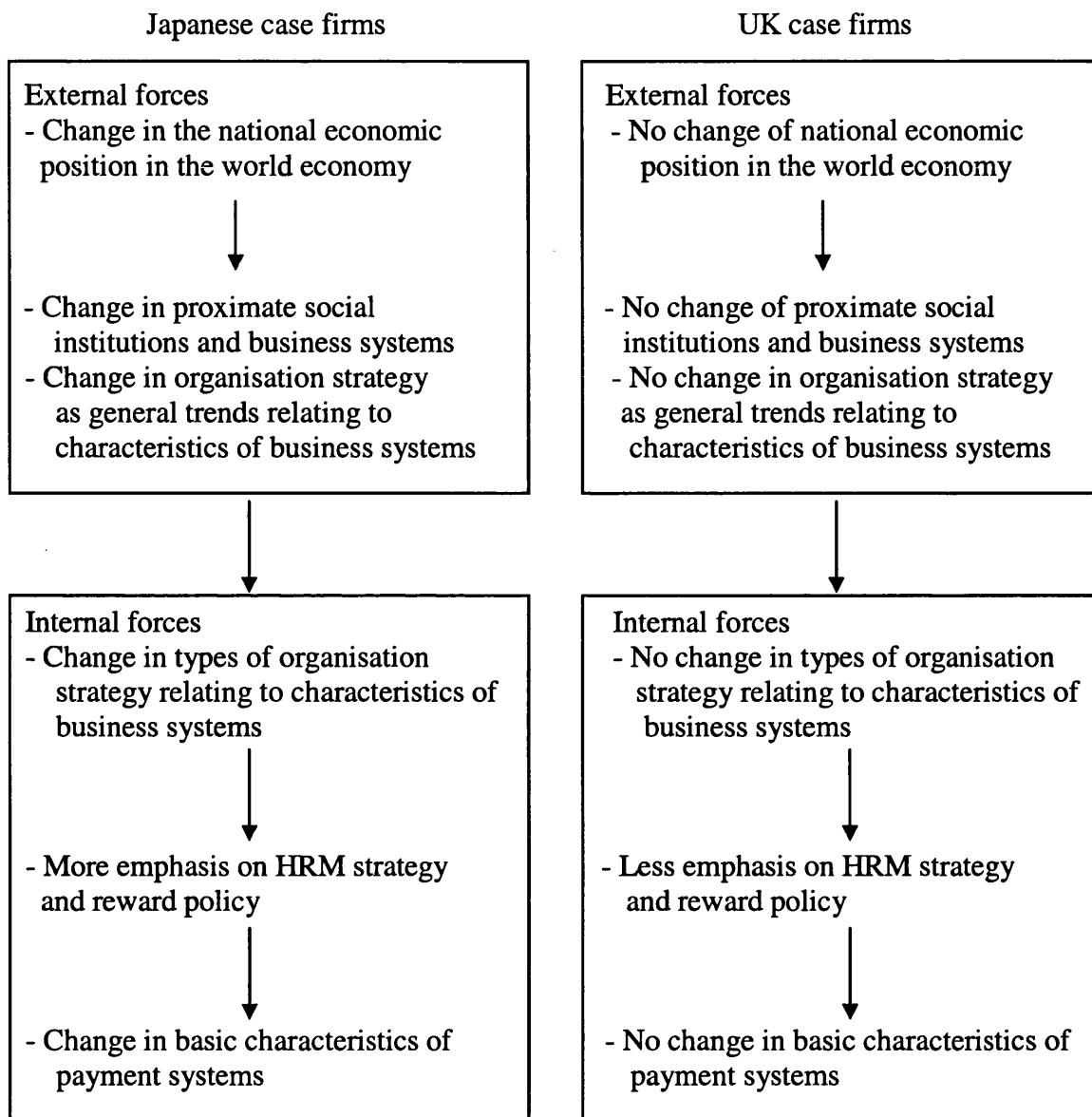
Secondly, emphasis on HRM strategy is considered. The author also found that the Japanese case firms are more likely to emphasise overall HRM as a strategic agendum than the UK case firms. In the Japanese case firms, six out of eight firms whose statements for organisation strategy were publicly available¹³⁰, stated that the HRM strategy was an important strategic agendum. For example, Company JF1 included HRM strategy in its five main strategies and Company JC1 included HRM strategy in its four main strategies. Amongst the case firms in the UK, only one firm – Company BC1 – included HRM strategy in its six important strategies for the firm.

As described, the link between organisation strategy and reward policies in the Japanese case firms is generally stronger than in the UK case firms, and the Japanese case firms generally place more emphasis on overall HRM areas as being important strategies than do the UK case firms.

As a result, payment systems in the Japanese case firms have been changing more than those in the UK case firms. The relationships between external and internal environmental change forces and the extent of changes in payment systems in the two countries found through this current research are illustrated in figure 9-1.

¹³⁰ As Company JR1 is not listed company and Company JT3 is subsidiary of the UK telecom firm, organisation strategies of these two firms are not publicly available.

Figure 9-1: Relationships between external and internal change forces, and change of payment systems in case firms in Japan and the UK.



Notes: Relationships described in figure 9-1 are general tendencies. There are variations among the case firms in each country. For example, CompanyBC1 states HRM issues as part of main strategic agenda in its investor relations information. In this aspect, Company BC1 is considered as emphasising HRM strategy.

9.6 Changes in the three factors in proximate social institutions and business systems

The original cause of change in the basic characteristics of payment systems in the Japanese case firms is considered to be the shift of Japan's economic position in the world economy. However, the Japanese economic position changed a long time ago, and the need for a change in the economic governance structure has been evident for a long

time. But this did not generate fundamental changes in the characteristics of Japanese management and business systems such as an emphasis on long term relationships in areas such as employment and trade until recently (Okazaki and Okuno 1993, Odaka 1993, Noguchi 1995). Minor fundamental change in the Japanese business system may be the reason for the small degree of fundamental change in Japanese payment systems until recently.

From these facts, it is considered that a change in the general economic position is not in itself sufficient to change concrete policies such as the payment systems of a firm. Concrete changes are needed in areas that form the Japanese economic structure in order to generate the fundamental changes in payment systems in each firm. Therefore, recent changes in proximate social institutions and business systems may be a more direct cause of the changes in organisation and HRM strategies, including payment systems, in the case firms. Hence, this section summarises the changes in the three factors of financial systems, shareholder structure and corporate governance structure in the proximate social institutions and business systems as more direct causes of the fundamental shift of payment systems in the case firms.

9.6.1 Directions of change of the three factors

(1) Financial system

Financial systems in Japan are characterised by a credit-based system. The credit-based system allows firms to have a long term perspective for their business and it encourages the traditional Japanese payment system which is person-, stock- and organisation-based. However, changes in financial systems in Japan are now happening, or are required. As the changes in financial systems in Japanese firms, including the case firms, were discussed in sections 9.3 and 9.4, the discussion here focuses on government policy. The Japanese government is trying to change the financial system from credit-based finance to a mixture of capital- and credit-based finance. There are two main purposes for this change. One is that a credit-based system is suited to a catch-up economy, but not a front runner economy. As uncertainties in the Japanese economy have increased now that it is a front runner, the financial systems must have functions that can find, manage and allocate financial risk. Financial systems with these functions must centre the market mechanism that enables effective price mechanisms and smooth capital

allocation. Banks must change lending behaviour from long term relations based to controlling credit. Within relations based banking, banks do not strictly conduct credit control on each credit, but rather judge credit control on the total assets of borrowers and their long term profitability. Property often represents a borrower's assets. Banks lend capital to borrowers based on property valuation, under the assumption that the price of the property never decreases. Such lending behaviour generated the bubble economy and therefore bad credit following the collapse of that economy. This is the second reason for changing financial systems. If the credit-based finance system continues, bad credit can happen again (Financial Service Agency 2002). The government is now trying to change the financial system because of these reasons.

(2) Shareholder structure

Shareholder structure in large Japanese firms is characterised by a small number of major stable and cross shareholders with business relationships. This type of shareholder structure encourages long term employment, investment for employees and the traditional Japanese payment system. However, after the collapse of the bubble economy, stable/cross shareholdings have been declining due to a decrease in share prices. Furthermore, as banks must comply with the regulations of the BIS (Bank for International Settlement) on capital ratios, banks are required to sell stable/cross shareholding. As banks sell stable/cross shareholding held by banks, business firms with stable/cross shareholding with banks sell shares in those banks. A more recent change is the change in accounting systems in relation to the evaluation method for holding shares from historical cost to market value¹³¹. Another change is the implementation of a new law stating that cross shareholding by banks must not exceed their capital. This law may be implemented from September 2004. Due to these changes, stable/cross shareholding has been decreasing over the last several years as described in table 9-5.

¹³¹ The government plans to change the evaluation system about cross shareholding. In the original plan, changes would start from the financial year ending March 2002, but the government suspended the changes due to the bad financial situation of many Japanese firms. The starting date of the changes has not yet been decided at the time of writing the thesis (2003).

Table 9-5: Proportion of stable/cross shareholding

	Money value base		Share number base	
	Stable share holding rate	Cross share holding rate	Stable share Holding rate	Cross share Holding rate
1987	45.8%	18.4%	42.5%	14.5%
1990	45.6%	18.0%	43.1%	15.0%
1994	44.9%	17.4%	41.2%	14.2%
1997	40.5%	15.1%	37.7%	13.1%
1999	37.9%	10.6%	33.9%	11.1%
2001	30.2%	8.9%	30.5%	9.1%

Data source: NLI Research Institute (2002)

(3) Corporate governance structure

Corporate governance structure in Japan is characterised by an insider system. The insider system also encourages the traditional Japanese payment system. However, changes in financial systems and shareholder structure have been leading to changes in corporate governance structure. Managers are now more sensitive to the interests of their shareholders (Japan Investor Relations Association 2000, 2002) and shareholder values such as share price, profit and dividends (Japan Institute of Labour 1999, Japan Association of Corporate Executives 1999). There is a greater requirement for information disclosure in areas such as organisation strategies and financial results. In 2003, the legal framework of internal corporate governance structure changed to increase the control of external auditors or non-executive board members. These changes are change forces for corporate governance structure in Japanese firms.

As described above, the three factors are now changing. The Japanese case firms perceive changes in these factors as general trends in Japanese business systems, and they more or less respond to these changes. Although the degree and content of responses differ, the case firms follow the same basic direction.

9.6.2 Origin of the three factors

Although the three factors are now changing, this has just started and it cannot be decided to what extent it will proceed. According to Whitley (1992a, 1992b, 1997, 1999), social institutions are divided into two types; background social institutions and

proximate social institutions. The background social institutions are concerned with the basic characteristics of human behaviour and relationships. The proximate social institutions constitute the immediate business environment and they have been formed under the influence of the background institutions. Therefore, the proximate institutions and business systems fit together to make the background institutions, thus, the proximate institutions and business system tend to be stable for a long time.

The three change forces identified as having close relationships with payment systems in this thesis are the proximate social institutions and business systems. If the three change factors were formed based on background social institutions as Whitley claims, the three factors may be stable, but if the characteristics of the three factors were formed by the attempts of some interest groups rather than under the influence of the background institutions, the characteristics may be more changeable. Thus, the thesis traces back the origins of the three factors in order to investigate the possibilities of changes.

(1) Financial system

The character of the financial system as a credit-based system started during the Second World War and was established between the end of the war and the 1970s. Before the late 1930s, capital-based finance was the main source of finance, for example, 87% of industrial finance was gathered from capital markets in 1931 (Noguchi 1995). However, financial systems changed radically due to a change in government policy. In 1939, the *Kokka Soudouin Hou* (National Mobilization Law) limited dividends. In 1940, the *Kaisha Keiri Touseirei* (Company Accounting Control Act) further limited dividends. The profit left by the limitation of dividends was allocated to employees, including agency managers. Firms had difficulties with capital-based finance because of the limitation of dividends, and so credit-based finance increased. The government implemented a new system to encourage credit-based finance and in 1941, the *Jikyoku Kyoudou Yuushi* (financial system by bank syndicate) started. This is the origin of the main bank system. In 1942, the *Kinyuu Tousei Dan Shirei* (Finance Control Act) expanded the scale of finance by bank syndicates. In 1944, the *Gunjyu Yuushi Shitei Kinyuu Kikan Seido* (financial institution appointment system to finance military supply) was implemented. Under this appointment system, all bank loans by bank syndicates were conducted under the name of the main banks. This is the origin of the

fixed relationship between the main banks and business firms (Teranishi 1993, Ueda 1993, Noguchi 1995, Miyamoto et al. 2001). Banks expanded their scale and established their position as the centre of finance under the war system. After the war, banks were given exemption from *Shuuchuu Haijyo* (elimination of capital concentration) by the Allied Army and they maintained their positions as the main financial institutions. Business firms had difficulties in raising finance from capital markets, because there were so few investors in the capital market at the time. They had to rely on banks (Suzuki 1998, Matsumura 1997, 2000).

(2) Shareholder structure

The characteristics of shareholder structure as a small number of stable and cross shareholders with business relationships started after the Second World War. Before the end of the war, *zaibatsu* families had a large proportion of shares. After the end of the war, shares held by *zaibatsu* families were released, allocated to employees and bought by ordinary individual investors through the capital markets. But employees who were allocated the shares had problems holding them due to financial difficulties. Generally there were very few individual investors at the time. Under the circumstances, firms found it difficult to maintain share prices. After the relaxation of the anti-monopoly law, stable/cross shareholding started mainly between firms in the former same *zaibatsu* groups, to stabilise and increase their share prices and to prevent takeovers. In the 1960s and 1970s, stable/cross shareholding increased in order to prevent takeovers by foreign capital, as predicted by capital liberalization. In the 1970s, corporate shareholders became the largest shareholding sector (Ueda 1993, Okumura 1998, Morimoto 1999, Suzuki 1998, Matsumura 1997, 2000).

(3) Corporate governance structure

The character of the corporate governance structure in post-war Japan as an insider system started after the Second World War. Before the end of the war, firms were controlled by *zaibatsu* families who were the major shareholders. Firms were indirectly managed by agent managers hired by *zaibatsu* families in large *zaibatsu* groups, and directly managed by owner managers in small *zaibatsu* groups. However, this type of corporate governance structure started to change under the war system. Between the mid 1930s and 1945, the government decreased the power of shareholders and increased

the power of employees, including agent managers, in order to increase the nation's productivity. In 1939, the *Kokka Soudouin Hou* (National Mobilization Law) limited dividends and resolution by shareholders. In 1940, the *Dai Nippon Sangyou Houkokukai* (committee made up of shareholders, managers and employees with the aim of increasing productivity) was established. This increased the status of employees to formal partners in increasing productivity. In 1943, the resolution of shareholders was further limited. Through these policies, the power of shareholders decreased. Instead of shareholders, it was the agent managers and employees who had the power. Finance methods changed at the same time, from capital- to credit-based finance. The power of banks became stronger and the relationships between banks and business firms became closer (Okazaki and Okuno 1993, Miyamoto et al. 2001, Noguchi 1995, Morimoto 1999). After the Second World War, stable/cross shareholding started between firms with business relationships and it expanded. The power of minor shareholders with no business relationships was weakened by stable/cross shareholding among major shareholders with business relationships. The power of agent managers and employees was further strengthened and the credit-based financial system further progressed. Surveillance and control by banks was established (Matsumura 1997, 2000, Shimotani 1993, Noguchi 1995).

9.6.3 Possibility of change in the three factors

The characteristics of all three factors were mainly formed through the attempts of some interest groups before, during and after the Second World War. The main interest groups were the government and agent managers in large firms. The formation of these characteristics had no direct relationship with background social institutions, therefore, the possibility of change in the three factors may be high, if powerful coalition groups change their interests to proximate social institutions and business systems again.

In fact, the Japanese government is now trying to change proximate social institutions and business systems. Indeed, the case firms are now changing their organisation strategy as a response to changes in proximate social institutions and business systems. The current situation is similar to that of the late 1930s. Whilst the government in the 1930s succeeded, it is not certain they will succeed again. The current characteristics of the three factors in proximate social institutions and business systems may be suited to the historically formed background social institutions. This may be one of the reasons

why these proximate social institutions and business systems have been operating for a long time and why Japan achieved economic growth in the post-war period. Hence, the current attempts to change may be more difficult than attempts to change in the 1930s and 1940s.

In addition, the Japanese government is now trying to change from a credit-based financial system to a mixture of credit- and capital-based systems. The case firms are trying to change their financial methods in the same direction. If the changes are realised, government control over firms' finances will become more difficult than under credit-based system (Whitley 1992a, 1992b, Kanter 1996, 1997). If we follow this logic, this shift in financial systems can make the government's attempts more difficult.

This discussion relates to another factor of proximate social institutions that has facilitated the traditional Japanese payment system and that is the role of the Japanese government as a 'development type' (Whitley 1992a). The government can intervene in private business activities through banks, under a credit-based financial system, and business firms can reduce their risk by sharing that risk with the government, which has a positive role in economic activities. Decreasing the risk of firms by risk sharing with the government has a similar effect on payment systems as that produced by the three factors, as discussed in chapter 4. However, if financial systems change, the role of the government may be reduced. The reduction of the government's role in economic activities would mean a shift towards the UK type of government as a 'regulatory type'.

9.7 Environmental change forces that differentiate the change stages between Japanese case firms

Environmental change forces that differentiated the extent of change in the case firms between Japan and the UK were identified. This is the most important finding in this research because the research objective was to identify the extent of change (and especially whether or not the basic characteristics of change is focused) and explain how and why the change occurs in the Japanese payment system as compared with the UK payment system as discussed in chapter 1.

The author next considers the different environmental change forces among the case firms in one country. Although this point is not the main research objectives, the author

thinks that this is, at least to some degree, still significant. For example, it can help in the investigation of diffusion mechanisms in payment systems' changes in one country by identifying what types of firms initiate changes in the payment systems. Furthermore, motivation for the author to try to examine this issue derived from that following facts found by the author through the case studies. That is, although the Japanese case firms have generally been changing their payment systems more than the UK case firms, these changes do not occur uniformly in these Japanese firms. Some case firms change more than others.

Discussion in this respect focuses on the Japanese case firms and excludes the UK case firms. There are two reasons for this selection. One is that the research objective is to identify and to explain the extent of change, and how and why the change occurs in Japanese payment systems and not in the UK payment system. The UK payment system is used as a comparison, and is not the main target of the research. The other reason is that the research found changes in the basic characteristics of the Japanese payment system, but the research found little change in the basic characteristics of the UK payment system, although the research found changes within the same basic characteristics. Therefore, the extent of change is much larger in the Japanese payment system than the UK payment system. Hence, investigation of diffusion mechanisms in changes in payment systems in Japan is more significant than that for the UK case firms.

The research found that changes to payment systems in the Japanese case firms are largely divided into three stages as discussed in section 8.3 in chapter 8. Further, the author identified the change stage of each case firm as indicated in table 8-5 in section 8.3.3 in chapter 8. The author then examined the relationships between environmental change forces indicated in table 9-1 in section 9.3.1 in this chapter and the change stage of each case firm indicated in table 8-5¹³². The examination of relationships between environmental forces and the payment system change stages focuses on low context/contingency change forces. The reason for high context/institutional change forces being excluded from the examination is that all organisations in the same society share these types of environmental factors, if institutional theory is applied. Institutional

¹³² It should be remembered, as already discussed in chapter 8, that there is little relationship between industrial sectors and the change stages, although many environmental change forces are differentiated by industrial sector as indicated in table 9-1.

theory that emphasises cognitive processes of people¹³³ hardly considers the reaction of individual organisations among organisations that share the same society or same organisational field. This is because organisations are embedded in society and institutional environments penetrate organisations, therefore, organisational boundaries become blurred for high context/institutional environments. Hence, only environmental change forces in low context/contingency change forces whose influence differs between the case firms were examined for the relationship between the environmental change forces and the three change stages in payment systems.

The following environmental change forces are selected among environmental change forces indicated in table 9-1 as the subject of the examination; 'national economic situation as recession', 'position in an industrial sector on the global scale', 'change of technology', 'labour market situation', 'ownership structure in terms of shareholding by holding company', 'ownership structure in terms of change in shareholder structure', 'trade union structure', 'perspective and reaction of employees in terms of recruiting and retention aim', 'financial results', 'strong link between organisation strategy and reward policy', and 'change in employment policy.' 'Ownership structure in terms of change in shareholder structure' has two aspects: one is decreasing stable shareholders and increasing foreign shareholders and the other is takeover by UK firms. Only the former type is examined among the two aspects, because this thesis limits the subject to Japanese-owned firms in Japan as discussed in section 9.3.1. The reason for the selection is that these change forces are forces pointed out only by one or some case firms not by most or all case firms, or degree of influence differs between the case firms among the environmental forces indicated in table 9-1. The assumption for the selection of environmental change forces is that environmental change forces differentiated by each firm may be the causes for differences in the change stages in payment systems.

As a result of the examination between the environmental change forces and the three change stage, the author found three change forces that have correlations with the three steps of change stages in payment systems.

The three factors are:

- ① Ownership structure in terms of change in shareholder structure -- large proportion of foreign shareholders

¹³³ This thesis calls this version of institutional theory as new institutional theory as indicated in section 4.4 in chapter 4

Where the proportion of foreign shareholders is high, the payment systems change more towards the introduction of job and market factors.

② Strong link between organisation strategy and reward policies

Where the link between organisation strategy and reward policies is strong, the payment systems change more towards the introduction of job and market factors.

③ Change of employment policy -- reduction of 'lifetime employment'

Where the case firms clearly change their employment policy to reduce lifetime employment, the payment systems change more towards the introduction of job and market factors.

That is to say, case firms with three factors changed their payment system more than other case firms.

The relationships between the three factors and changes in payment systems are considered. The first is the high proportion of foreign shareholders. Company JC1 and Company JC2 have high proportions of foreign shareholders. The payment systems in the two firms are at the most progressed stage in terms of change. The reason for the correlation between high proportions of foreign shareholders and changes in the payment system is that foreign shareholders tend to require higher profits, and this causes further changes to the payment systems. In fact, the two firms particularly strongly emphasise increasing shareholder value and state their specific policy to increase shareholder value in the IR (Investor Relations) information, whilst increasing emphasis on shareholder value is a general tendency among the Japanese case firms as discussed in section 9.3.1 in this chapter. Whereas foreign shareholders encourage the importance of shareholder value, foreign investors have a tendency to hold shares in firms with high profits¹³⁴, and Company JC1 and Company C2 maintain high levels of profits. The causal relationship in terms of which is a cause and which is an effect cannot be determined. Nonetheless, it is assumed that once firms have a high proportion of foreign shareholders, they must keep high levels of profits in order to maintain their share prices. The relationship may be cyclical.

The second is the strong link between organisation strategy and reward policies.

¹³⁴ According to a survey by Nippon Keizai Newspaper (2002b), foreign investors tend to concentrate their investment on high profit firms, and especially firms with high ROE (Return on Equity).

Company JF1, Company JR1, Company JC1 and Company JC2¹³⁵ are categorised by the strong links between organisation strategy and reward policies in section 9.3.1 in this chapter. Amongst the four firms, Company JR1, Company JC1 and Company JC2 are categorised at the most progressed stage, and Company JF1 is also categorised at a relatively progressed stage. From these facts, it is considered that the case firms have set their reward policies as a high priority in order to achieve their organisation strategies and are more likely to change their payment systems to introduce job and market factors.

The third factor is employment policy. Where the case firms explicitly emphasise changes in the employment policy to reduce lifetime employment which spread in post-war Japan, and to restructure the relationship between individual employees and the firms, the firms change their payment systems more to the introduction of job and market factors. Company JR1, Company JC1 and Company JC2 are at the most advanced stage of change in their payment systems as discussed in section 9.3.1 in this chapter. In chapter 3, the author argued that the main reason for many Japanese firms choosing person-based payment systems was the choice of lifetime employment. This is because there is no limit on the person factor unlike the job factor at least in theory. The person-based system is suited to lifetime employment. However, if employment policy changes, payment systems can change, because firms do not have a strong need for the maintenance of a person-based payment system any more. This may be the situation in Company JR1, Company JC1 and Company JC2. Company JF1 is also changing its employment policy, although to a lesser degree as discussed in section 9.3.1 in this chapter.

As discussed, the three factors that differentiate change stages in payment systems are internal factors. There are no external factors that differentiate change stages. For instance, there is little evidence that industrial sectors differentiate change stages in payment systems as discussed in section 8.3.3 in chapter 8. Therefore, it is considered that the case firms' responses are not necessarily the same, even though they are surrounded by similar external environments. These responses are consistent with the assumptions of theories such as the resource based view (Barney 1991, Dierickx and Cool 1989, Lado and Wilson 1994), core competence (Prahalad and Hamel 1990,

¹³⁵ Criterion used for the categorisation is whether the Investor Relations information includes reward policies as discussed in section 9.5 in this chapter.

Hamel and Prahalad 1993a, 1993b), strategy formation processes as emergent strategies (Mintzberg 1978), cognitive or behavioural approaches for organisations (Simon 1965, March and Simon 1958, Cyert and March 1963), strategic decisions (Child 1972) and corporate culture (Schein 1999). In other words, every firm has unique characteristics within their organisation in many areas, such as their competitive advantages, strategic formation processes and social and political situation. This uniqueness differentiates their competitive advantages (Barney 1991, Prahalad and Hamel 1990, Hamel and Prahalad 1993a, 1993b).

9.8 Difference of influence by industrial sector

There is little industrial effect on the change of payment systems in both Japan and the UK as identified in chapter 8. However, there is one discernible industrial effect in the UK in terms of the degree of emphasis on competencies. Two food and drink firms (Company BF1 and Company BF2) whose main business is alcoholic drinks more emphasise competencies for pay purposes among the UK case firms. For example, only two firms put the same priority on output performance and competencies for overall ratings in performance reviews, and emphasis on the use of competencies for pay purposes, whereas other case firms emphasised more the output aspect. The author speculates that one of the reasons why Company BF1's emphasis on competencies may be the influence of Company BF2. The use of competencies in Company BF2 is well published as an example of competency approach, and this may have influenced Company BF1 as a firm in the same industrial sector. In fact, HR practitioners in Company BF1 knew of the use of competencies in Company BF2, although they did not mention that their decision for placing emphasis on competencies was influenced by Company BF2.

The author considers two reasons for the little difference according to industrial sector for change stages in payment systems in the Japanese case firms and one recognisable difference according to industrial sector found in the UK case firm. The first reason is that the extent of industrial sector effects for the Japanese case firms is concerned with three stages divided according to whether job and market factors for individual pay determination have been introduced. The extent of industrial effects for the UK case firms is concerned with the degree of emphasis on competencies for pay purposes. Therefore, differences in payment systems concerning the three stages according to the

introduction of job and market factors (Japanese case firms) is much larger than differences in payment systems concerning the degree of emphasis on competencies (UK case firms). If relatively detailed differences for the Japanese case firms are examined, some relatively minor differences compared with the three stages concerning the introduction of job and market factors can be found.

The second is that the extent of payment system changes in the Japanese case firms is much larger than that in the UK case firms. Furthermore, this thesis identified original reasons for this greater extent of changes in Japan as changes in the national characteristics of economic structure and social institutions. Therefore, stronger change forces (as changes in the national characteristics in economic structure and social institutions) than industrial sector exist for the Japanese case firms. But such stronger change forces were hardly recognised by the UK case firms. This may be the reason why industrial effects were not found as being change forces for payment system change in the Japanese case firms. In other words, stronger change forces overwhelm industrial effects, even though industrial sectors can influence changes to the payment system to some degree. On the other hand, strong change forces such as changes in national characteristics of proximate social institutions and business systems were not found for the UK case firms. This difference may be the reason for the difference in the degree of industrial effects between the two countries.

9.9 Summary

This chapter investigated environmental change forces that made changes in the Japanese payment system larger than those in the UK payment system. Firstly, external and internal environments, and HRM and payment systems in individual case firms were described. The author then identified the environmental change forces in low context/contingency factors and high context/institutional factors for the payment systems in the Japanese and UK case firms.

Based on the identification of the environmental change forces for both Japan and the UK, the author compared the environmental change forces between the two countries. As a result, the author found that both low context/contingency factors such as the product and service market situation and high context/institutional factors such as national characteristics of business systems functioned as change forces for the Japanese

case firms. On the other hand, low context/contingency factors such as the product and service market situation functioned as change forces for the UK case firms, but high context/institutional factors in terms of national economic and social characteristics were hardly recognised as change forces¹³⁶. This difference is considered as a reason why payment systems in the Japanese case firms are changing more than payment systems in the UK case firms

Furthermore, internal environmental forces are also different. The Japanese case firms generally place more emphasis on HRM strategy as an important organisation strategy and on reward policy as part of the overall HRM area than the UK case firms. They may be the internal factors of payment systems in the Japanese case firms that change more than in payment systems in the UK case firms.

Then, the thesis investigated the recent situations and origins of financial systems, shareholder structure and corporate governance structure, which were identified as original causes for the greater extent of payment system changes in the Japanese case firms than in the UK case firms. The reason for the investigation for the origins of the three factors was to examine whether characteristics of the three factors were formed based on background institutions or formed by the deliberate attempts of coalition groups. As a result, the research found that deliberate attempts by coalition groups such as the government and agent managers in private firms formed the characteristics of the three factors. Therefore, the possibility of future changes in the Japanese payment system may be high.

The author next identified environmental change forces that differentiate the extent of the payment system changes in the Japanese case firms. Although this investigation is not the main research objective, it may still have some significance, for example for the identification of diffusion mechanisms of the payment system changes in Japan. As a result, the three factors of 'change of shareholder structure towards increasing foreign shareholder', 'strong link between organisational strategy and reward policy' and 'change of employment policy towards reduction of lifetime employment' were identified as the differential factors. All three factors are internal factors. The case firms with the three internal factors initiate the payment system changes.

¹³⁶ The research found that 'general trends in HRM and payment system' as high context/institutional change force for the UK case firms. However, this factor is not concerned with national economic and social characteristics.

Chapter 10: Conclusion

10.1 Major research findings

The research objective was to examine the direction and extent of changes in payment systems in large private sector Japanese firms. The researcher selected as its approach an international comparative approach to examine the direction and extent of the change, with the UK as the subject of the comparison. The thesis firstly identified the basic characteristics of the Japanese payment system as a person-, stock- and organisation-based system and the UK payment system as a job-, flow- and market-based system based on the literature research. These basic characteristics in the Japanese UK payment systems provide the basis of the investigation of the direction and extent of the change. That is to say, if these characteristics for each country change, the change is considered fundamental.

Furthermore, the research objective includes explaining how and why changes occur. The selected approach to achieve this objective was the investigation of the relationship between external and internal environments and payment systems; how and why environmental factors influence changes to payment systems were investigated. The theoretical framework to specify the environmental factors were low context and high context perspectives as articulated by Child (2000). Furthermore, contingency theory and institutional theory were identified as theoretical underpinnings for low context and high context perspectives respectively.

The research selected case studies as the most suitable research method to achieve the research objectives. This is because case studies can gather a rounded picture of a situation using a variety of both quantitative and qualitative methods. A rounded picture is necessary in order to establish relationships between environmental factors and payment systems whose relationships are intertwined in a complicated manner.

Case studies of ten Japanese firms and eight UK firms were conducted in order to achieve the research objective. Although the research specified potential influential environmental factors and the author had in mind these factors during the case studies, she did not impose these factors when gathering the data during the case studies. In other words, the potential influential environmental factors were identified by an

analytical or deductive approach. The author changed her stance towards the inductive approach in order to increase the amounts of data gathered. This is because if she had imposed the potential influential factors derived from the use of the deductive approach, she would have lost opportunities to gather data that were not considered before the case studies. The purpose of the case studies was to gather data about what was happening in a real setting.

As a result of the case studies, many differences between the case firms in Japan and the UK were found. Among the many differences of the payment system in each country, three differences were considered as being particularly significant. One of the reasons why the author considers the three distinctive characteristics as significant is that they support the three basic characteristics of payment systems in Japan (person-, organisation, and stock-based) and in the UK (job-, market-, and flow-based) identified by this thesis. The three distinctions are; 'emphasis on long term sense of equity', 'centralised decision making for individual pay determination' and 'psychological contract as 'pay for age'' for the Japanese payment system, and 'emphasis on sense of equity for each occasion of pay determination', 'decentralised decision making for individual pay determination', and 'psychological contract as 'pay for job and contribution'' for the UK payment system. Although these three distinctions were found through the case studies, the reasons for the three distinctions can be explained by the three basic characteristics. Therefore, the three distinctions are considered as being consequences of the three basic characteristics. Furthermore, the author found that the three distinctions also fitted in with each other, and fitted in with the employment system as either organisation-based or market-based just as the three basic characteristics.

However, at the same time the research found the three basic characteristics of payment systems as person-, organisation- and stock-based, in the Japanese case firms are now changing, while the basic characteristics are not changing in the UK case firms (although the research found some changes within the same basic characteristics). Then, the research investigated this difference in relation to internal and external environmental change forces. The author argued that the external environmental forces are original causes and the internal environmental forces are generated under the influence of the external forces, although reverse relationships are also taken into account. Therefore, the differences in the external environmental forces in the two

countries were given focus.

In the Japanese firms, low context/contingency factors such as change in market, and high context/institutional factors, which constitute the economic and business framework in the country, such as proximate social institutions and business systems, have been changing and functioning as change forces. On the UK side, the main change force is market factors such as change in market. There was little evidence that high context/institutional factors, which constitute the social economic and business framework in the country, such as proximate social institutions and business systems have been changing. As a result, these social institutional factors do not function as change forces for payment systems in the UK. General trend in HRM and payment systems as an institutional factor is a change force in the UK case firms, but this factor does not constitute the social economic and business framework in the country. Accordingly, this thesis assumes that whether or not the basic characteristics of payment systems -- person-, stock- and organisation-based system, or job-, flow- and market-based system -- change depends upon whether or not both contingency factors and institutional factors, which constitute the national economic and business framework in a country, function as change forces for payment systems. Contingency factors in the country alone are not sufficient to change the basic characteristics of payment systems.

In Japan, the original cause of change may be the change of the Japanese position in the world economy. This factor is an economic and contingency factor, but this factor initiates change of social institutional factors such as proximate social institutions and business systems. Further, the thesis traced back the historical evolution of the three change forces in proximate social institutions and business systems -- financial system, shareholder structure and corporate governance structure. As a result, characteristics of these three factors were formed through the deliberate attempts of powerful coalition groups such as government and agent managers in large firms, rather than by influence of background social institutions. Therefore, the possibility of change of the three factors may be high.

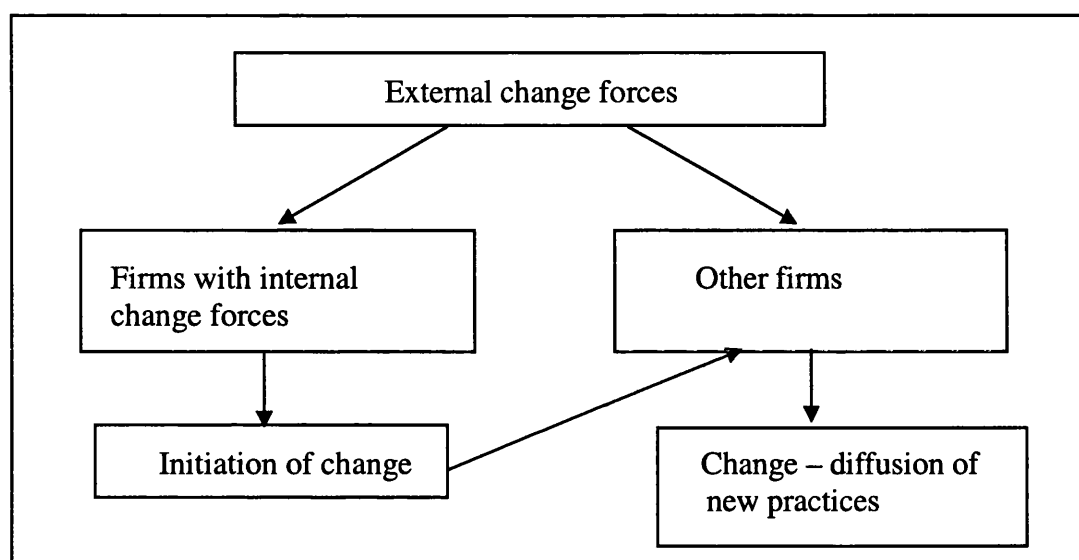
The research found another feature of payment system change in the Japanese case firms. That is, various aspects of change in the payment system do not occur simultaneously. Certain aspects of the change initiate other aspects. That is, change

from a stock-based towards a flow-based system occurred first in the Japanese case firms. This change encouraged other aspects such as a person- and organisation-based system. As a result, the Japanese case firms introduced job and market factors for individual pay determination. This pattern of change as a sequence of change supports the configuration perspective among three popular perspectives in HRM.

The author next examined environmental change forces that helped explain the extent of change in payment systems between the Japanese case firms. This was not the main research objective, but still has some significance, because it could reveal diffusion processes in payment system change in Japan. Three change forces -- 'change of shareholder structure towards increasing foreign shareholders', 'strong links between organisation strategy and reward policy' and 'changes in employment policy towards reduction of lifetime employment' -- were identified as the change forces that differentiate the extent of change of payment systems in the Japanese case firms. All three change forces are internal factors. Although many change forces are differentiated by industrial sectors, an industrial effect could not be found as a factor that would differentiate the degree of change. There is little relationship between industrial sectors and the payment system change stage. The change stage differs among case firms within the same industrial sectors.

Just as this thesis identified three environmental forces that differentiate the extent of change in payment systems between the Japanese case firms, it now identified the change diffusion process in a society. The following change diffusion process in payment systems is considered based on the research findings. A small number of firms with internal change forces precede more general change. Other firms may follow these new trends created by a small number of firms, if the mimetic process of institutional isomorphism (DiMaggio and Powell 1983) is applied. In fact, the research found that case firms in Japan and the UK are influenced by general trends in HRM and payment systems. Firms within the same society or organisational field share many external environmental factors. Therefore, if some firms initiate a change, firms that share the same external environments are likely to follow that change. Furthermore, as the theoretical underpinnings of trends develop, firms are more likely to adapt to these trends which have spread in their society. The change diffusion process is illustrated in figure 10-1.

Figure 10-1: Change diffusion process



10.2 Generalisability of the research findings

This research found various aspects of change in the payment systems in the Japanese case firms. The main findings can be categorised by three aspects. The first is that ‘the basic characteristics in Japanese payment systems are now changing’. This is the most significant finding of this research. The second concerns the external environmental change forces that differentiate the degree of change between the case firms in Japan and the UK. This is the second important findings of this research. The third concerns the environmental change forces that differentiate the degree of change between the Japanese case firms. Here the generalisability of the research findings in these three aspects for the large private sector Japanese firms, which are the population of this research, is examined.

The first examination stated that ‘the basic characteristics of Japanese payment systems are now changing’. The main concern for this finding is whether or not it can be applied to the export sector. The research selected five industrial sectors -- telecom, food and drink, chemical and pharmaceutical, retail and oil -- in order to reduce the extraneous variables of international comparative research. As a result, the research encountered another problem regarding whether research findings can be generalised to other industrial sectors. In particular, the subjects of the case studies were limited to the import or domestic sectors in Japan (in the UK, the case firms are more global). Export sectors such as automobiles and electrical industries were excluded. Therefore, whether

the research findings can be generalised to large firms in the export sector was a question because external environments differ between import and export sectors. That is to say, although this research achieved criteria for generalisation set by two sampling logics of analytical generalisation as discussed in chapter 5, testing by these two logics did not include characteristics relating to whether the sector was export or import.

The answer may be 'yes'. The case firm industries are more regulated and/or protected than export sector industries, although regulations are now relaxing. Regulation and protection are included as reasons why the case firms tend to be domestic and consequently weak in global competition, as Porter (2000) argues. On the other hand, firms in the export sector have been facing strong market competition both domestically and globally. Increased market competition is a change force for the payment systems in all of the case firms. From these facts, it is assumed that large firms in the export sector tend to initiate changes in payment systems, since these firms have been facing environmental change forces more than the case firms. Hence, the research finding which states that the 'Japanese payment system is now changing towards a job-, flow- and market-based system', can be applied to the export sector.

The second examination relates to the external environmental forces that differentiate the degree of change between Japan and the UK. The research concluded that both contingency factors and social institutional factors are needed as change forces in order to change the basic characteristics of payment systems. On the Japanese side, both factors are now functioning as change forces. On the UK side, only contingency factors are functioning -- social institutional factors do not function as change forces due to little change of these factors. This is the main cause of the difference in the degree of change between the two sides. This finding can be generalised to other large private sector firms in Japan and the UK because the characteristics of social institutions and business systems are applied to all firms in the same society.

The third examination relates to the environmental forces that differentiate the degree of change between the Japanese case firms. Three internal factors -- change of shareholder structure towards increasing foreign shareholders, the strong links between organisation strategy and reward policy, and changes in employment policy towards reduction of lifetime employment -- were identified as the forces. Generalisability may be high, because two sampling logics for analytical generalisation were achieved. However, the

degree of the generalisability may be lower than the first and second aspects. This is because the number of case firms is smaller in this aspect than the first and second aspects. The first and second aspects concern comparison between the Japanese and UK case firms. The number of the case firms is eighteen. The third aspect concerns the Japanese case firms. The number of the case firms is ten.

10.3 Convergence or divergence between two types of payment systems

The research found that the Japanese payment system is now changing towards a system similar to that of the UK in some respects. Hence, whether the Japanese payment system is wholly converging with the UK payment system or still remains divergent is considered. Here, unchanging aspects of the Japanese payment system are discussed first.

10.3.1 Unchanging aspect in payment systems in Japanese case study firms

This thesis has discussed the changing aspects of the basic characteristics, however, there are few changes in the characteristic of centralised decision making for individual pay determination. One exception is Company JT3 (UK-owned firm) that changed its individual pay determination system toward the strengthening of decisions by each line manager through increased decision making power during performance reviews¹³⁷. According to the interviewees in Company JT3, this change is influenced by practices in the UK parent firm.

Centralised decision making of individual pay determination is formed as consequence of the person-, stock- and organisation-based payment system. However, these systems are now subject to change. Hence, it is considered that centralised decision making may change through changes in other characteristics, but there are little changes on this aspect alone.

Two reasons are considered for the small degree of change in decision making structures. One is that employees in the Japanese case firms do not realise that their decision making is centralised. This is because most of these employees have no

¹³⁷ Company JT3 changed the name of its appraisal function from *jinji kouka* to 'performance review', as described in chapter 6.

experience of other types of decision making and they cannot imagine any other types. HRM practices in Western countries for the other aspects of payment system characteristics such as job-based and market-based were introduced to the case firms. The Japanese case firms often cite Western practices and make comparison between the Japanese and Western payment systems. However, there were no comments from the Japanese case firms about the Western practice of decision making structures for individual pay determination. From the author's point of view, information delivered to Japanese firms about Western HRM practices is patchy and some areas lack information. Decentralised decision making for individual pay determination is one example of this. Although Japanese practitioners tend to know that line managers have stronger decision making power in relation to HRM issues in Western countries, they do not know the concrete methods of how decisions are made by line managers. Japanese case firms cannot change in areas that they do not perceive as distinctive characteristics of the Japanese payment system and they do not know alternative methods. This may be an example of the cognitive limitations claimed by institutionalists (DiMaggio 1988, Zucker 1988, Scott 1998) and may confirm claim of the cognitive/behavioural approach of organisations (Simon 1957, March and Simon 1958, Cyert and March 1963).

The other reason is that a change in the decision making structure can bring about a change in power relationships which would strengthen line managers and weaken the HR practitioners. Therefore, HR practitioners may resist a change in decision making structures. For these reasons, changes in decision making structure hardly occur, or if it does, it may be slow.

10.3.2 Other differences between the payment systems of the case study firms in Japan and the UK

There are many other differences. For example, there are many differences between performance reviews in the UK and *jinji hyouka* (evaluation) or *jinji kouka* (appraisal)¹³⁸ in Japan. In the UK, the performance review is the only assessment tool operating in line relationships, but various types of evaluation tools operate in line relationships in Japan. Accordingly, the performance review in the UK includes both development and judgement purposes, but types of evaluation for development purposes

¹³⁸ The thesis translates *jinji hyouka* that include all types of employee assessment as evaluation in English, and *jinji kouka* that deals with the judgement purpose of pay and grade review as appraisal in English (see section 3.3.6 in chapter 3 or Appendix IV).

and for judgement purposes are separated in Japan. Furthermore, there are usually more than two types of appraisal in Japan. Another difference is the types of elements of base-pay between the two countries. In Japan, there are two types of elements of base-pay, namely *tanitsugata chingin* and *heizongata chingin*¹³⁹, but there is only *tanitsugata chingin* in the UK as a type for elements of base-pay.

It is certain that the three basic characteristics in the Japanese payment system are now shifting in the direction of the three basic characteristics in the UK payment system. Therefore, we can see that the Japanese payment system is converging with the UK payment system as the overall direction to some degree. However, all characteristics do not necessarily change: for example the centralised decision making structure for individual pay determination is an unchanging aspect. Furthermore, if we consider the details of the payment systems, there are many differences between them, as exemplified by the differences in the performance review in the UK and *jinji hyouka* (evaluation) or *jinji kouka* (appraisal) in Japan, and exemplified by the difference in types of elements of base-pay. Hence, the thesis concludes that the Japanese payment system is converging to some degree with the UK payment system in terms of overall directions, but divergent aspects still remain. Moreover, whether the divergent aspects will remain or change towards convergence cannot be concluded.

10.3.3 Changes in payment systems in the UK

This research found that payment systems in the UK case firms are static in terms of the basic characteristics. However, if the convergence or divergence of payment systems between Japan and the UK is considered, changes in the UK must not be ignored. Although the extent of the change is smaller, payment systems in the UK case firms are also changing. In terms of the direction of change, recent changes were pointed out as changes in job evaluation methods and pay structures. These changes are considered to be in the direction that further strengthens flow- and market-based payment systems.

Looking at longer term trends, an emphasis on individual contribution, especially output performance, is the trend in the case firms as well as being the general trend. This trend is considered as a change in the relative focus from a job-based system to a

¹³⁹ *Tanitsugata chingin* is base-pay constructed from one form or type of pay which contains several elements to determine pay levels and *heizongata chingin* is base-pay made up from more than two forms or types of pay (see section 3.3.6 in chapter 3 or Appendix IV).

person-based system. In performance reviews, assessments including the input aspect of the person factor, such as competencies, are considered to be the trend in the case firms as well as the general trend. Use of the input aspect of performance reviews relating to pay reviews can be interpreted as the introduction of a stock-based system. The person- and stock-based payment systems are the basic characteristics of the traditional Japanese payment system. Hence, it can be seen that UK payment systems have introduced characteristics of the Japanese payment system to some extent.

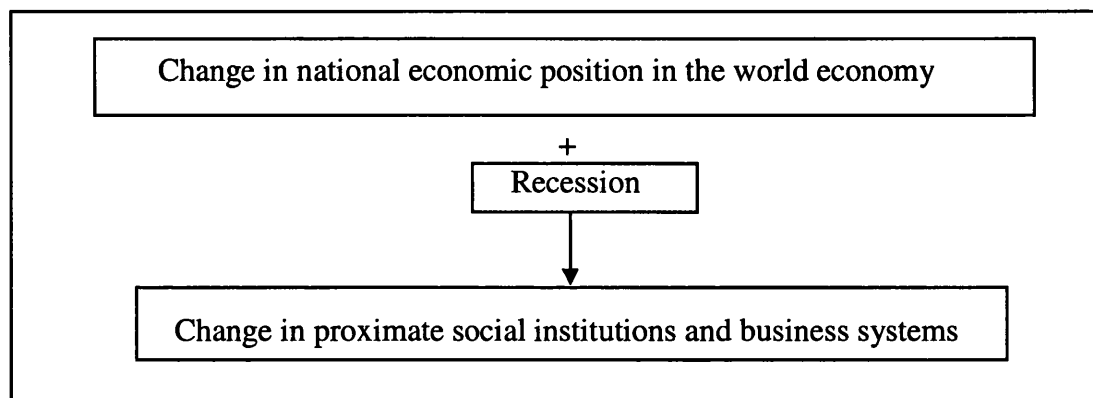
Furthermore, in the HRM area as a whole, Japanese management has influenced UK firms. For example, studies of HRM (Beer et al. 1984, Guest 1987, Wood 1996) often cite Japanese HRM as best practice. 'Japanization' was popular in the UK. One of the main areas in Japanese management introduced to the UK was HRM (Oliver and Wilkinson 1992). From this evidence, HRM in the UK, including payment systems, may be influenced by Japanese HRM to some degree. Therefore, it is considered that HRM in the UK, including payment systems, may be convergent towards the Japanese system in some aspects. At the same time, however, payment systems in the UK case firms are proceeding towards a more flow- and market-based system.

10.4 Speculation on future direction

This research found that a fundamental shift has occurred in payment systems in the case firms in Japan and that the generalisability of this shift may be high. In other words, the possibility of convergence towards the UK type of payment system can be high. However, the extent of changes in Japanese payment systems cannot be decided. As discussed, changes of proximate social institutions and business systems may be the reason why the Japanese side has changed more than the UK side. A change in the national economic position may initiate a change in the proximate social institutions and business systems. However a change in the Japanese economic position may be not sufficient to change the proximate social institutions and business systems as presented in Japan over the last thirty years. Changes in the proximate social institutions and business systems started to change over the several years, despite the fact that Japan became the second largest economy in the world around thirty years ago. From this fact, it is assumed that changes in proximate social institutions and business systems happen in nations that have economic difficulties under their current proximate social institutions and business systems. The relationships between the three external change

forces are described in figure 10-2.

Figure 10-2: Relationships between the external change forces



In terms of external change forces, the Japanese economic position in the world economy as a front runner economy may not change, at least in the short term, but the economic situation can change from time to time. If the current economic recession situation changes, changes in proximate social institutions and business systems could stop. In the 1980s, when the Japanese economy was strong, the superiority of the Japanese economic structure, or economic governance system, was celebrated (Vogel 1985, Albert 1992, Streeck 1996, Oliver and Wilkinson 1992, Ouchi 1981). If the Japanese economy turned good, such a situation could occur again and changes to proximate social institutions and business systems could stop. The extent of change and convergence in the Japanese payment system to the UK type payment system could be influenced by the economic situation in Japan.

However, at the same time it is considered that Japanese type of proximate social institution and business system is suited to a catch-up economy and this is cause of the current economic recession in Japan. For example, Japanese government claims that financial system characterised by credit-based system is suited to a catch-up economy, but not front runner economy (see section 9.6.1 in chapter 9). If this logic is right, credit-based financial system may be one of the causes of the current recession. Therefore, financial system should change towards reduction of credit-based finance in order to overcome the recession. If financial system changes towards reduction of credit-based finance and increase of capital-based finance, shareholder structure should change towards reduction of stable/cross shareholders and increasing shareholders whose purpose of holding share is capital gain in order to finance from capital market.

Further, if financial system and shareholder structure change, corporate governance structure should change towards outsider type. These changes are the same directions of the current change in Japanese case firms. In other words, change of proximate social institutions and business systems is necessary in order to overcome the recession. Turning good economic situation in the long term without change in proximate social institutions and business system will not happen.

Moreover, characteristics of three change forces in proximate social institution and business system – financial system, shareholder structure and corporate governance structure -- was formed by attempts of powerful coalition groups such as government and agent managers in large firms during and after the Second World War not by influence of background social institutions as discussed in chapter 9. Hence, possibility of change of these factors may be high.

In addition, once a type of payment system starts to change, this change should be completed, if the notion of internal fit or the configuration perspective in HRM theory is applied. This is because if part of a system has changed whilst other parts do not, the internal fit within the system would break. Some researchers (Arthur 1992, Osterman 1994, MacDuffie 1995, Ichniowski et al 1997) support the configuration perspective as discussed in chapter 4.

The author assumes that Japanese payment system may converge towards UK type of payment system in the future for these reasons.

10.5 Future research

Although the author assumes that the Japanese payment system may converge towards UK type of payment system in the future, further research on the following aspects is needed in order to conclude the direction.

Firstly, the perspective and reaction of employees must be analysed. Employees may perceive a change in the basic characteristics a breach of their psychological contract. A change in payment systems is generally considered as a breach of their psychological contract by employees. In particular, if critical and long used aspects of payment systems change radically, a breach of this psychological contract tends to have serious

consequences, such as decreasing commitment and motivation of employees (Rousseau 1995, Rousseau and Ho 2000). This employee reaction can influence the direction and extent of change in payment systems. This research more focuses on economic and social factors as external environmental factors and management decisions such as organisation and HRM strategies as internal environmental factors, but gives less attention to the perspective of employees, although the research does not ignore it. If the perspective of employees is focused on, another aspect of change may be revealed as discussed in convergence and divergence debate in chapter 4. That is, macro analysis for social development or research that focuses on formalistic and broad features of organisations tends to report convergence, whereas micro analysis or informal aspects of organisations such as mode of people's behaviour tends to report divergence (Child 1981). In fact, this research found that there are many differences in details and process of payment system as discussed in section 10.3.2 in this chapter.

The second is regarding HRM. Although the seniority system presupposes organisational expansion, Japan cannot expect high economic growth and organisational expansion, since Japan is now a front runner economy. The traditional Japanese payment system tends to result in seniority-related pay. Therefore, the payment system must change toward reduction of seniority-related pay. However, despite the fact that many Japanese firms already perceived change of seniority-related system in the 1970s, many Japanese firms have maintained the traditional Japanese payment system resulting in seniority-related pay (discussed in chapter 1). The main reason why many Japanese firms have chosen long term employment is that provision of high job security has become a social value (discussed in chapter 3). Therefore, change of social values should be examined, although researching social values is very difficult, as discussed in chapter 4.

This research focused on institutional theory in high context factors and contingency theory (as representing economic and technological approaches) in low context factors among five approaches presented by Child (2000). Cultural theory (including cultural information theory) in high context factor was not given focus and psychology in low context factor was less focused, although it was included. Therefore, culture and psychological factors should be analysed in order to capture a more holistic picture surrounding payment systems.

Moreover, if convergence or divergence between the Japanese and the UK systems is considered, we must not ignore the changes in the UK. Although payment systems in the UK are more static, they are still changing. Changes are towards the Japanese type of payment system in some respects, and toward strengthening the flow- and market-based payment systems as the basic characteristics of UK systems in other respects.

This research investigated changes in Japanese HRM by focusing on payment systems. In payment systems, convergence of the Japanese system towards the UK system is found. However, this finding is not necessarily applicable to other aspects of HRM because payment systems are just one part of HRM alongside a variety of other components and aspects. For example, Rowley and Benson (2002) found that the concrete practices and techniques used were likely to be convergent among four Asian countries, but the basic principles remained just as divergent among the four countries. Payment systems are categorised by concrete practices and techniques. Therefore, if this research result by Rowley and Benson is applied, the findings of this research do not necessarily fit other aspects of Japanese HRM. Further research is needed to capture the direction of Japanese HRM more comprehensively.

Japan utilised the late development effect, and Japan's emergent proximate social institutions and business systems were suited to a catch-up economy. However, once Japan reaches advanced nation status, proximate social institutions and business systems do not function effectively and change is required. Although the social institutions and business systems tend to be stable, they can change in relation to economic requirements (Lane 1995, Child 2000). Changes in the proximate social institutions and business systems have only recently started in Japan, to make them a more suitable type for a front runner economy. How Japan will deal with this change process remains an empirical question.

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Appendix I: Areas of payment systems and other types of financial rewards covered in the case studies

1) Base pay (*kihonkyu*)

1.1) Number of base pay systems operating in the case firms

1.2) Pay structures

- Elements that determine pay structure e.g. job-related or person-related
- Structure of pay grades and pay ranges

1.3) Elements of base-pay and monthly pay (particularly for Japanese firms)

1.4) Pay reviews

- Whether pay increase rate is determined through collective bargaining
- Elements considered in individual pay reviews
- Relationship between appraisals or performance reviews and pay reviews
- Appraisal or performance review processes
- Rating criteria and distribution of ratings
- Pay review processes

1.5) Grade promotions

- Grade promotion system
- Pay increases as promotion adjustment

2) Cash-based variable pay¹⁴⁰

2.1) Japanese firms – *shoyo* (biannual regular bonus)

- Proportion of biannual regular bonus compared with annual salary
- Whether biannual regular bonus is determined through collective bargaining
- Elements that determine individual biannual regular bonus levels
- Calculation of biannual regular bonuses
- Relationship between appraisal ratings and biannual regular bonus level
- Relationship between organisational performance and biannual regular bonus level

2.2) UK firms - cash-based variable pay

- Type of cash-based variable pay such as short term and mid/long term incentives

¹⁴⁰ Definition of variable pay used in the thesis is “proportion of total remuneration not consolidated into base-pay which has to be re-earned in each pay period (week, month or year). Examples of variable pay include sales incentives, annual profit-share, or cash bonuses based on estimates of employee performance” (Dictionary of HRM 2001: 392p)

- Contents of cash-based variable pay such as target employees
- Conditions of payment
- Conditions that determine the level of the variable pay

3) Share ownership

- Type of share ownership schemes operating in the case firms
- Purposes of the share ownership schemes
- Contents of the major share ownership schemes

4) Turnover money (*taishokukin*) system – for Japanese firms

- Basic policy for turnover money
- Contents of the turnover money system

5) Allowance (*teate*)

- Basic policy for allowance
- Contents of main allowances

6) Employee benefits

- Basic policy for employee benefits
- Contents of the main employee benefits schemes

Appendix II: Employee interview questionnaire

The Employee Interview Questionnaire is divided into sections for the case firms in Japan and those in the UK due to differences in pay review processes between the two. The questionnaire indicated here is the basic pattern. The contents of questionnaire were adjusted for each case firm's individual situation.

Questionnaire for case study firms in Japan

Line managers

- Your main responsibilities

Questions on your roles as an appraiser and a pay reviewer

1) Appraisals – about performance appraisals and competency/ability appraisals

- Who are your appraisees?
- Number of appraisees
- How to set objectives in performance appraisals
- How to assess competencies or abilities
- How to decide ratings for performance appraisals and competency/ability appraisals
- What kinds of information do you use for appraisees?
- How do you gather the information used during appraisals?
- Do your appraisees participate in the appraisal process?

If they participate:

- Frequency of meetings with your appraisees
- Contents of appraisal meetings
- How long do you spend preparing for the setting of objectives and appraisal meetings per appraisee?
- How long do you spend on setting objectives and appraisal meetings per appraisee?
- Do you inform your appraisees of the results of their appraisals, including ratings?

If you inform them:

- Do your appraisees agree with the results?
- If your appraisees do not agree with the results, how do you deal with it?
- Communication other than formal meetings

2) Pay reviews

- Do you participate in any pay review processes other than appraisals?
- If yes, how do you participate?
- Do you know the pay levels of your appraisees?
- Do you explain reason the result of the pay review (monthly pay) and biannual regular bonuses to your appraisees?

Questions on your role as an appraisee and a pay reviewee

- Who is (are) your appraiser(s)?
- Do you participate in the appraisal process?

If you participate:

- How do you participate in the appraisal process?
- Does your appraiser inform you of the appraisal criteria and the result, including ratings?

If your appraiser informs you of the appraisal result:

- Do you agree with the result?
- If you do not agree with the result, how do you deal with it?
- Do you have any discussion about pay review result with your appraiser?
- Communication other than formal meetings

Non-line managers

- Your main responsibilities
- Who is (are) your appraiser(s)?
- Do you participate in the appraisal process?

If you participate:

- How do you participate in the appraisal process?
- Does your appraiser inform you of the appraisal criteria and result, including ratings?

If your appraiser informs you of the appraisal result

- Do you agree with the result?
- If you do not agree with the result, how do you deal with it?
- Do you have any discussion about pay review result with your appraiser?
- Communication other than formal meetings

Common questions for line managers and non-line managers

- Do you know the pay levels of employees with similar jobs in other firms in the same industrial sector?
- How do you perceive your firm's payment system or practices?
- What is the most important motivation factor related to your job?

Questionnaire for case firms in the UK

Line managers

- Your main responsibilities

Questions on your role as a performance reviewer and a pay reviewer

- Who are your performance reviewees and pay reviewees?
- Number of performance reviewees and pay reviewees

1) Pay reviews

- What factors do you consider and what is the most important factor in pay reviews?
- What kinds of information do you use for pay reviews?
- Do you explain the reason for the results of pay reviews to your pay reviewees?

If you explain:

- If your pay reviewees do not agree with the results, how do you deal with it?

2) Performance reviews

- How to set objectives and how to decide ratings in performance reviews
- How to decide ratings for performance review
- How to assess competencies
- What kinds of information do you use for performance reviews?
- How do you gather the information used during performance reviews?
- Do your performance reviewees participate in the performance review process?

If they participate:

- Frequency of meetings with your reviewees
- Contents of performance review meetings
- How long do you spend preparing the setting of objectives and the performance review meetings per reviewee?

- How long do you spend setting objectives and performance review meetings per reviewee?
- Do you inform your reviewees of the results of their performance reviews, if including ratings?

If you inform:

- Do you agree the results of the reviews with your reviewees?
- If your reviewees do not agree with the results, how do you deal with it?
- Communication other than formal meetings

3) Pay determination of new recruits

- How to set base pay level of new employees

Questions on your role as a performance reviewee and a pay reviewee

- Who is (or are) your appraiser(s) and pay reviewer(s)?

1) Pay reviews

- Does your pay reviewer explain the reason for result of your pay reviews?

If your pay reviewer explains:

- What points does your pay reviewer emphasise during the decision on your pay reviews?
- If you do not agree with the result of your pay review, how do you deal with it?

2) Performance reviews

- Do you participate in performance review processes?

If you participate:

- How do you participate in the performance review processes?
- Does your performance reviewer inform you of the criteria and result of performance reviews, including ratings?

If your reviewers inform you of the result of your performance reviews:

- Do you agree with the results of performance reviews?
- If you do not agree with the result, how do you deal with it?
- Communication other than formal meetings

Non-line managers

- Your main business responsibilities

- Who is (or are) your performance reviewer(s) and pay reviewer(s)

1) Pay reviews

- Does your pay reviewer explain the reason for result of your pay reviews?

If your pay reviewer explains:

- What points does your pay reviewer emphasise during the decision of your pay reviews?
- If you do not agree with the result of your pay review, how do you deal with it?

2) Performance reviews

- Do you participate in the performance review processes?

If you participate:

- How do you participate in the performance review processes?
- Does your reviewer inform you of the result of your performance reviews, including ratings?

If your reviewer does inform you:

- Do you agree with the results of your performance reviews?
- If you do not agree with the result, how do you deal with it?
- Communication other than formal meetings

Common questions for line managers and non-line managers

- Do you know the pay levels of employees with similar jobs in other firms in the same industrial sector?
- How do you perceive your firm's financial reward systems or practices?
- What is the most important motivation factor related to your job?

Appendix III: Internal documents provided by the case firms

Japanese case firms

Company JT1 (Telecom industry)

- Industrial analysis
- Organisation strategy
- Organisation structure
- Employee compositions

Overall Human Resource management (HRM)

- Purpose and contents of change in HRM system
- Grade structure and grade promotion systems
- Relationship between job, title and grade

Pay

- Change in elements of monthly pay
- List of allowances
- Contents of main allowance (conditions of payments, levels of payments)
- Pay structure
- Pay increase/decrease rates according to each rating category
- Pay range for each grade
- Standards of payments for allowances
- Amounts of money for *shoyo* (biannual regular bonus) according to the rating category of each grade
- Pay increase accompanying grade promotion
- List of employee benefits
- Contents of main employee benefits (conditions of payments, levels of payments)

Appraisals

- Purpose and content of each type of appraisal
- Appraisal sheet (Management by Objectives (MBO) sheet, performance appraisal, competency appraisal)
- Competency profiles including behavioural indicators
- Criteria on job-related abilities (*shokunou youken*)
- 360degree feedback sheets
- Rating criteria and distribution rates

Others

- Career development system

Direction of change in HRM system (planned change starting 2002 financial year)

- Industrial analysis
- Organisation strategy
- Purpose and directions of change in HRM system
- Contents of change in each HRM area

Company JT2 (Telecom industry)

- Industrial analysis
- Organisation strategy
- Employee compositions

Overall HRM

- Purpose and contents of change in HRM system
- Grade structure and grade promotion systems
- Relationship between job, title and grade

Pay

- Elements of monthly pay
- List of allowances
- Standards of payments for allowances
- Pay structures
- Pay increase and decrease rates according to each rating category
- Biannual regular bonus rate for each rating category
- Chingin hyou* (pay table) of base-pay for non-managers
- Amounts of money for age-related pay in each age range for non-managers
- Amounts of money for other types of base pay in each grade for non-managers
- Taishokukin* (turnover money) system
- List of employee benefits

Appraisals

- Policy and contents of each type of appraisal
- Appraisal sheet (MBO sheet, performance appraisal, competency appraisal, etc.)
- Competency profiles including behavioural indicators
- Rating criteria and distribution rates

Company JT3 (Telecom industry, UK-owned)

- Employee compositions

Overall HRM

- Purpose and contents of HRM system
- Description of old grade system
- Purpose and contents of change in grade system
- Transfer policy to new grade system

Pay

- Elements of pay (yearly pay) according to each job category
- Policies on pay for each job category
- Change of pay structures
- Pay ranges – old system and new system
- Standard of pay levels in each grade in each job category
- Pay increase rate according to each rating category
- Biannual regular bonus rate according to each rating category
- Criteria and calculation of short term incentive plan applied globally in the group firms
- Calculation of *taishokukin* (turnover money)
- Conditions of share options
- Contents of employee benefits

Performance management

- Process of performance management
- Rating criteria and rating categories
- Competency profiles

Others

- Contents of working conditions

Company JF1 (Food and drink industry)

- Analysis of external environment
- Organisation strategy
- Employee composition

Overall HRM

- Description of old HRM system
- Purpose and contents of change in HRM system
- New grade structure and grade promotion systems

-Role grade definitions

Pay

- Comparison of base-pay system between old and new systems
- Comparison between Japanese payment systems and Western payment system
- Elements of monthly pay
- Comparison of biannual regular bonus system within old and new systems
- Pay range of each grade – managers
- Chingin hyou* (pay table) – non-managers
- Amounts of pay increase and decrease money according to each rating category in each grade
- Biannual regular bonus rates according to each rating category
- Average amounts of pay increase money and biannual regular bonuses in last three years
- List of allowances
- Contents of main allowance (conditions of payments, levels of payments)
- Regulation on *souki taishoku* (voluntary turnover) programme
- Taishokukin* (turnover money) system and change of the turnover money system
- List of employee benefits
- Contents of main employee benefits (conditions of payments, levels of payments)

Appraisals

- Purposes and content of each type of appraisal
- Appraisal sheet (MBO sheet, performance appraisal, competency appraisal)
- Examples of appraisal sheets filled in with comments
- Competency profiles including behavioural indicators
- Criteria on ratings and distribution rate of rating categories

Others

- Career development systems
- Internal recruiting systems
- Regulations on health and safety, holiday and leave

Company JF2 (Food and drink industry)

- Analysis of external and internal environments
- Agenda of HR department
- Employee composition

Overall HRM

- Purpose and contents of HRM system
- Change of grade systems and grade promotion systems

Pay

- Policy and components of pay according to employee levels – board members, managers and non-managers
- Pay structure
- Elements of monthly pay
- Purpose and content of performance bonus relating to divisional performance
- Amounts of biannual regular bonus according to each rating category in each grade in 2000
- Policy of share options
- List of allowances
- List of employee benefits

Appraisals

- Purpose and content of each type of appraisal (ability appraisal, performance appraisal)
- Appraisal sheet (MBO sheet, performance appraisal, ability appraisal)
- Competency profiles including behavioural indicators
- Criteria relating to job-related abilities (*shokunou youken*)

Others

- Career development systems
- Assessment programmes

Company JR1 (Retail industry)

- Industrial analysis
- Organisation strategy

Overall HRM

- Review of new HRM system introduced in 1995
- Description of minor changes between 1996 and 1999
- New HRM system introduced between 2000 and 2002
- Grade promotion and demotion policy

Pay

- Comparison between Japanese payment system and Western payment system
- Job evaluation scheme

- Grade structure – relationship between job size (Hay point), job grade and position
- Pay ranges of each grade
- Examples of job descriptions
- Elements of yearly pay and monthly pay
- Pay increase/decrease rates according to each rating category
- List of allowances
- Change of biannual regular bonus schemes
- Biannual regular bonus rates according to each rating category
- List of employee allowances
- Contents of main employee allowances (conditions of payments, levels of payments)
- List of employee benefits
- Contents of main employee benefits (conditions of payments, levels of payments)

Appraisals

- Contents of each type of appraisal
- Competency profiles including behavioural indicators
- 360 degree feedback sheets
- Appraisal sheet until 2000 (performance appraisal)
- Examples of appraisal sheets since 2000
- Examples of appraisal sheets that comments are filled in
- Criteria for ratings

Others

- Career development system
- Support system for job-hopping
- Internal recruiting system
- New position retirement (*yakushoku teinen*) system

Company JR2 (Retail industry)

- Analysis of internal and external environments
- Organisational structure
- Employee composition

Overall HRM

- Purpose and contents of change in HRM system
- New grade systems and grade promotion systems

Pay

- Purpose and contents of change in payment system

- Contents of payment system for each employee category
- Chingin hyou* (pay table) for base pay – year 2000
- Amounts of age-related pay – non-managers
- Amounts of money accompanying grade promotions
- Elements of yearly pay and monthly pay
- Pay increase rates according to each rating category in each grade
- Biannual regular bonus rates according to each rating category in each grade
- List of allowances
- Contents of main allowance (conditions of payments, levels of payments)
- List of employee benefits
- Contents of main employee benefits (conditions of payments, levels of payments)

Appraisal system

- Purpose and content of each type of appraisal
- Appraisal sheets (performance appraisal, ability appraisal)
- Criteria for ratings

Company JC1 (Chemical and pharmaceutical industry)

- Industrial analysis
- Change of organisational structure
- Employee composition

Overall HRM

- Objectives of HR department
- Change in the HRM system

Pay

- Purpose and content of change in payment system
- Job evaluation schemes
- Relationship between job size (Hay point) and job grade
- Examples of job descriptions
- Grade- and role-related competency profiles including behavioural indicators
- Comparison between Japanese payment systems, Western payment systems and the payment system of the firm
- Elements of monthly pay
- Pay increases and pay curve policy
- Change in biannual regular bonus system
- Change in *taishokukin* (turnover money) system

- Calculation of turnover money
- Change in allowances
- List of allowances
- Contents of main allowances (conditions of payments, levels of payments)
- Change in employee benefits
- List of employee benefits
- Contents of main employee benefits (conditions of payments, levels of payments)

Appraisals

- Comparison between Japanese type of appraisal and Western type of appraisal
- Purpose and content of each type of appraisal (performance appraisal, competency appraisal)
- Appraisal sheets (performance appraisal, competency appraisal)
- Criteria for ratings

Others

- Selection and promotion systems

Company JC2 (Chemical and pharmaceutical industry)

Overall HRM

- History of change in the HRM system
- Contents of change in the HRM system in 1996, 1999 and 2000
- Employment policy
- Change of grade structures and grade promotion/demotion systems
- Grade- and role-related competency profiles including behavioural indicators

Pay

- Contents of yearly salary system for senior managers
- Contents of role-related pay system for below middle managers
- Elements of yearly pay for senior managers and monthly pay for below middle managers
- Elements of biannual regular bonuses
- Pay structures
- Pay increase and decrease policy
- Pay range of each grade
- New age-pay profiles in each grade
- New pay dispersal by age groups
- Change of *taishokukin* (turnover money) system

- Change in allowances
- List of allowances
- Change in employee benefits
- List of employee benefits

Appraisals

- Purpose and content of each type of appraisal (performance appraisal, competency appraisal)
- Criteria for ratings

Others

- Career development systems
- Support for job-hopping
- Kibou taishoku* (voluntary turnover) system

Company JO1 (Oil industry)

Overall HRM

- Purpose and contents of change in HRM system
- Grade structures and grade promotion systems
- Relationship between position and grade

Pay

- Elements of monthly pay
- Pay increase rate for each rating category
- Biannual regular bonus rates for each rating category
- List of employee benefits

Appraisals

- Purpose and content of each type of appraisal (ability appraisal, performance appraisal)
- Appraisal sheets (ability appraisal, performance appraisal)
- Criteria for ratings

Others

- Career development systems

UK case firms

Company BT1 (Telecom industry)

- Industrial analysis
- Organisation strategy
- Organisation structure

Overall HRM

- Employment policy
- Employee booklet for 'Our Vision'

Pay

- Reward policy
- Pay structure
- Pay range of each pay band
- Examples of job descriptions
- Pay review policy in 2001
- Pay increase rate related to each rating category
- Purpose of annual bonus scheme
- Eligibility and target rate of annual bonus for each pay band
- Purpose of senior executive share options
- Eligibility and target rate of senior executive share options
- Regulation of senior executive share options
- SAYE (Save As You Earn) share option scheme (levels of savings, levels of grants by the firm, calculation of options, methods of payments)
- Other share ownership schemes (levels of savings, levels of grants by the firm, calculation of options, methods of payments)
- List of allowances
- Contents of main allowances (conditions on payments, levels of payments)
- Booklets on group pension scheme (conditions of payments, calculation of payments, levels of payments)
- Booklet on healthcare system
- Regulations on company cars
- Eligibility for company car for each pay band
- Level of company car and cash alternative for company car for each pay band

Performance management

- Objectives and contents of performance management

- Criteria for ratings
- Performance management sheets (performance review sheet, career development review sheet)
- Behaviours based on 'Our Vision'
- Competency profiles including behavioural indicators

Others

- Application form for employment
- Disciplinary and grievance procedures
- Employee information handbook
- Assessment and development policy
- Main training and development programme
- Policies on health and safety, leave, equal opportunities, sexual and racial harassment, etc.

Company BT2 (Telecom industry)

- Several industrial analyses by external consultancy firms
- Analysis of external environment
- Organisation strategy
- Organisation structure

Overall HRM

- Employment and people management policy
- Analysis of employee profiles
- Analysis of the HRM system and employer brand

Pay

- Global reward strategy
- Total reward policy
- Policy on each component of reward
- Reward components by employee levels
- Manager's guide for rewards
- Retention policy, manager's guide for retention
- Base-pay policy
- Salary benchmarking – how to use salary benchmarking data
- Salary survey data – raw data of three club salary surveys in which Company BT2 participates (High tech industry survey, high tech industry compensation survey, telecom operators survey)

- Contents of salary survey data

Participants list, review of the survey data such as average total increase, starting salaries, bonus policies, commission policies, profit-sharing plans, share ownership plans, company cars, allowance policies, vacation days and hours worked, overtime pay practices, company benefit plans, career structure (job family structure), career map of each job family, description of job family, career stage in job family and job area, salary survey data on each job including things such as functional description, job level, sample size, company car eligibility, base-pay without car (average, lower decile, lower quartile, upper quartile, upper decile), base-pay adjusted for car (average, lower decile, lower quartile, upper quartile, upper decile), total cash package without car (average, lower decile, lower quartile, upper quartile, upper decile), total cash package with car (average, lower decile, lower quartile, upper quartile, upper decile)

- Reward policy for global senior manager (main policies, components of reward, conditions and levels of short-term cash bonus, conditions and levels of share options)

- Policy on short term incentive plan

- Policy and calculation of short term incentive plan 2001/2002

- Policy on share options

- Discretionary share option scheme (method of selection for employees granted options, conditions of options, levels of options for each employee level)

- SAYE share option scheme (levels of savings, levels of grants by the firm, calculation of options, methods of payments)

- Other share ownership scheme (levels of savings, levels of grants by the firm, calculation of options, methods of payments)

- List of flexible benefits

- Contents of each option within flexible benefits (calculation of benefit, levels of benefit)

- Contents of other employee benefits

Performance management

- Policy of performance management

- Performance management toolkit – manager's guide

- Competency profiles including behavioural indicators

- Criteria for ratings

- Performance review sheet

Others

- Value assessment of individuals
- Risk assessment of turnover
- Manager's kit for retention
- Global employee attitude survey in the UK and US
- Disciplinary procedures
- Redundancy policy
- Survey of cultural integration in Japanese subsidiary

Company BF1 (Food and drink industry)

- Industrial analysis
- Organisation strategy
- Organisation structure
- Employee composition

Overall HRM

- Link between organisation strategy and HRM system
- Purpose of change in HRM system
- New main HRM policies
- Employee grade structures
- Grade definitions (role and competencies required)

Pay

- New reward policy
- Time schedule for change of reward system
- List of firms set as competitors in job market
- New global rules for reward components
- New rules on levels of base pay, annual incentives and long term incentives
- Policy on each reward component for each region
- Audit of reward practices
- Employees' reaction to new reward system
- Pay structures
- Share option policy
- List of employee benefits
- Contents of each option in flexible benefits (calculation of benefit, levels of benefit)
- Examples of the application of flexible benefits

Performance management

- Purpose of performance management
- Performance management process
- Performance review sheet
- Competency profiles including behavioural indicators
- Criteria for ratings
- Assessment of performance management practices

Others

- Questionnaire for competency assessment
- Analysis of corporate culture

Company BF2 (Food and drink industry)

- Industrial analysis
- Organisation strategy
- International comparison of compensation policy
- Organisation structure
- Employee composition
- Key performance indicators
- Brand building strategy
- Integration process for UDV and Guinness

Overall HRM

- Strategic agenda in HRM area
- Overview of implementation of new HRM policies
- Employee level definitions (role and competencies)

Pay

- Global reward strategy
- List of firms set as competitors in job market
- Reward components and eligibility for each component in each employee level
- Level of each reward component for each employee level
- Pay structure
- Booklet of short term incentive schemes (purpose, conditions of payment, methods of calculation, levels of payments)
- Booklet of share options (purpose, conditions of payment, methods of calculation, levels of payments)
- Booklet of senior executive share option plan (purpose, conditions of payment,

methods of calculation, levels of payments)

- Other types of share ownership schemes (purpose, conditions of payment, methods of calculation, levels of payments)
- Group pension scheme (purpose, conditions of payment, methods of calculation, levels of payments)
- Other employee benefits
- Employee benefit by each employee level (eligibility, levels)

Performance management

- Purpose of performance management system
- Performance management process
- Performance review sheets
- Development assessment sheet
- Competency profiles including behavioural indicators
- Assessment of career potential
- Aim of 360 degree feedback
- Components of 360 degree feedback

Others

- Development policy
- Overview of implementation of new development policies
- Main training programmes
- Managers training for employee development

Company BF3 (Food and drink industry)

- Organisation strategy
- Organisation structure

Overall HRM

- Purpose of HRM

Pay

- Global reward strategy
- Pay structure
- Criteria for job evaluation

Performance management

- Purpose performance management
- Process of performance management
- Performance review sheet (performance review sheet, development review sheet)

- Rating categories
- Criteria for ratings

Company BR1 (Retail industry)

- Industrial analysis
- Organisation strategy
- Employee composition

Overall HRM

- Mission and role of HR department
- Main HRM policies

Pay

- Reward policy
- Elements of financial rewards
- Pay structure
- Examples of role profiling
- Lists of employee benefits

Performance management

- Purpose of performance management system
- Performance management process
- Performance review sheet (performance review sheet, personal development sheet)
- Competency profiles
- Criteria for ratings
- 360 degree feedback sheet
- Components of 360 degree feedback

Others

- Development system
- Main training programmes

Company BC1 (Chemical and pharmaceutical industry)

- Organisation strategy

Overall HRM

- Employee composition
- HRM policy

Pay

- Reward policy

- Pay structure
- Pay review policy

Performance management

- Purpose and content of performance management system
- Process of performance management
- Competency profiles
- Examples of 360 degree feedback

Company BO1 (Oil industry)

Pay

- Reward policy
- Pay grade structure
- Reward components
- Elements considered in pay reviews
- Firms set as competitors in the job market
- Share option schemes in the UK and US

Appendix IV: Glossary of pay and employment in Japan, related to the thesis

Base-up

Elements of annual pay increases in Japan are divided into *base-up* and *teiki shoukyu* (regular pay increase). *Base-up* is the part of an annual pay increase which is determined by inflation, market trends and the firm's ability to pay. Base-up is a method by which the pay standards of organisations are increased.

Chingin

Employers' pay to their employees considered as the price of the employees' work.

Chingin taikei

Method used to decide individual pay levels, focusing on the elements which make up monthly pay. For example, a firm decides on the elements of monthly pay which are base pay, manager allowance and dependent allowance. The proportion for each element is as follows: 70% for base-pay, 20% for manager allowance and 10% for dependent allowance. Furthermore, the firm divides the base-pay element into age-related pay and grade-related pay, and sets each element as 60% for age-related pay and 40% for grade-related pay, within the base pay. The above elements and proportion of each element refer to *chingin taikei*.

Chingin hyou

Pay table that shows the position of every pay level within a firm.

Chingin seido

Method used to decide individual pay levels, focusing on how total pay cost is distributed over individual pay levels. For example, decisions in areas such the percentage of monthly pay which is related to appraisal ratings, how appraisal ratings are decided and the relationship between ratings and pay increase/decrease rates are included in *chingin seido*.

Fukuri kousei

This term corresponds with 'employee benefit' in English. There are two types of *fukuri kousei*: employee benefit voluntarily determined by each firm and employee benefit determined by laws. The main characteristic of *fukuri kousei* is that the voluntarily

determined employee benefit covers a wide range of various benefits, especially in large firms.

Gakureki betsu nenji kanri

Labour management method that treats one cohort with the same level of academic background who entered the firm at the same time through graduate recruiting as one unit of employee management.

Gou or gouhou

Minimum pay level unit expressed as a pay point within each grade in the pay table (*chingin hyou*)

Gyouseki kouka

Appraisal that assesses the output aspect of the person factor, such as results or output performance. This thesis translates '*gyouseki kouka*' as 'performance appraisal' in English.

Heizongata chingin

Base-pay (*kihonkyu*) composed from more than two forms or types of pay.

Jidou shoukyu

Automatic pay increase due to age and years of service. This is one type of *teiki shoukyu* (regular pay increase).

Hi-seishain/hi-seikishain

Other types of employees except *seishain* (full-time and permanent employees), such as part-time and contract employees. The concept of *seishain* in Japan is narrower than in other advanced countries, and extrinsic rewards such as promotion, pay and employee benefit are largely differentiated between *seishain* and *hi-seishain*.

Jinji or jinji kanri

Personnel Management or Human Resource Management (HRM).

Jinji hyouka

All types of employee assessment, including judgment and development purposes. This

thesis translates *jinji hyouka* as ‘evaluation’ in English.

Jinji kouka

Employee assessment mainly dealing with judgment purposes such as pay increases/decreases, biannual regular bonus and grade promotions/demotions. This thesis translate *jinji kouka* as ‘appraisal’ in English.

Jitsuryoku shugi jinji

Contribution-based HRM that includes ability-based HRM (*nouryoku shugi jinji*) and output performance-based HRM (*seika shugi jinji*). *Jitsuryoku shugi jinji* indicates the opposite people management principle to seniority-based HRM (*nenkou shugi jinji*). Although meaning of *jitsuryoku* is more equivalent to such as merit or ability, the author translates ‘contribution’ from content of *jitsuryoku shugi jinji* that include both input emphasised HRM (ability-based HRM) and output emphasised HRM.

Kihonkyu

This term corresponds to ‘base-pay’ in English.

Kihonkyu chingin taikei

Elements of base-pay. There are two types of *kihonkyu chingin taikei*: *heizongata chingin* and *tanitsugata chingin*. The former refers to base-pay (*kihonkyu*) composed from more than two forms or types of pay and the latter refers to base-pay (*kihonkyu*) constructed from one form or type of pay which contain several elements.

Kijunnai chingin

There is no formal legal definition of *kijunnai chingin*. In ordinary usage, *kijunnai chingin* is often indicates certain areas within *shoteinai chingin*.

Kijungai chingin

Kijungai chingin is part of the monthly pay excluded from *kijunnai chingin*.

Kyuyo

Employer’s pay to their employees considered as the price of the employee’s work. The concept of *kyuyo* is broader than that of *chingin*. Benefits provided by employers by their voluntary action, such as celebration money or condolence money, are included in

kyuyo, but *chingin* includes only financial benefits determined by formal employment regulations or collective bargaining.

Model chingin

This term is translated as ‘model pay’ in English. *Model chingin* indicates the pay levels of employees whose pay has been increased by the standard level under the payment system operated in the firm concerned. *Model chingin* is calculated in relation to age, years of service and number of dependents, divided by academic background and sex.

Nenpou sei

Nenpou sei is translated as ‘yearly salary system’ in English. This is the pay determined on a yearly basis and based on result of appraisal that mainly focuses on output performance.

Nouryoku shugi jinji

Ability-based HRM. Ability indicates the input aspect of the person factor such as skills, knowledge, attitude and behaviour. The English words corresponding to ‘*nouryoku*’ are those such as ability, capability, capacity and competence. This thesis uses ‘ability’ as the English translation for ‘*nouryoku*’. *Nouryoku shugi kanri* emerged in the 1960s as the opposite people management principle to seniority-based HRM (*nenkou shugi jinji*) which was wide spread after the Second World War in Japan.

Nouryoku kouka

Ability appraisal that assesses the input aspect of the person factor such as skill, knowledge, attitude and behaviour.

Osoi senbatsu/osoi shoushin

Late selection or late promotion. A large difference in promotion and pay levels among a cohort with the same academic background, is not made until the late career stage. These promotion and pay practices are seen to be opposite to the tournament system.

Satei shoukyu

One type of *teiki shoukyu* (regular pay increase) determined through appraisals. This term is expressed as ‘appraisal-related pay increase’ in English.

Seika shugi jinji

Result- or output performance-based HRM. *Seika shugi jinji* emphasises the output aspect of the person factor. *Seika shugi kanri* is different from *nouryoku shugi jinji* (ability-based HRM) that emphasises the input aspect of the person factor such as skills, knowledge, attitude and behaviours. *Nouryoku shugi jinji* has been emphasised since the 1960s or 1970s and *seika shugi jinji* emerged in the 1990s. *Nouryoku shugi jinji* was generated as the opposite people management principle to seniority-based HRM (*nenkou shugi jinji*). However, *nouryoku shugi jinji* tends to have a seniority element due to the difficulty in assessment of the input aspect of the person factor. *Seika shugi jinji* emerged in order to overcome this weakness in *nouryoku shugi jinji* by emphasising output performance.

Seishain/seikishain

Full-time and permanent employee. The concept of *seishain* in Japan is narrower than the concept of full-time and permanent employee in other advanced countries.

Shoguu

Meaning of *shoguu* is treatment as a word in English. In HRM area, *shoguu* is used as extrinsic reward mainly promotion and pay.

Shokumukyu

Job-related pay.

Shokunoukyu

Job-related ability pay or pay based on ability to perform job.

Shokumu suikou nouryoku

Ability to perform job.

Shokunou shikaku seido

Qualification system based on job-related ability. This qualification system divides employees into grades according to their job-related ability. This system is the most widespread system in HRM in Japan.

Shokunou shikaku toukyu

Qualification grade based on job-related ability.

Shokunou youken

Criteria relating to job related abilities.

Shoteigai chingin

This is where pay is paid by non-fixed amounts of money. Amounts of *shoteigai chingin* vary according to factors such as working time (e.g. overtime allowance and midnight duty allowance) and conditions or types of work (e.g. shift allowance and stand-by allowance).

Shoteinai chingin

Pay is paid regularly (usually monthly) with fixed amounts of money for work within regular working times.

Shoukaku shoukyu

Pay increase determined by promotion of qualification grade.

Shoyo

This term corresponds to a cash-based company-wide bonus or profit-sharing in English. *Shoyo* is expressed as 'biannual regular bonus' in English, since *shoyo* is also known as a bonus in Japan, and the biannual payment of bonus is institutionalised there in Japan.

Sougou kouka

Comprehensive appraisal by mixture of ability appraisal and performance appraisal.

Sougoukyu

Pay determined by a comprehensive judgment considering several elements such as job contents, job related abilities, age, years of service and academic background.

Tanitsugata chingin

Base-pay (*kihonkyu*) constructed from one form or type of pay which contain several elements.

Taishokukin

This term is expressed as 'turnover money' in English. *Taishokukin* is divided into two types. One is *taishoku ichijikin* which is money paid as a lump-sum when employees leave firms or retire. The other is the money that employees receive after retirement as *kigyou nenkin* (company pension).

Teate

This term corresponds to 'allowance' in English. *Teate* is paid as a supplement to base pay. Types of *teate* are largely divided into *kihonkyu chousei teate* and *kihonchingin hojyu teate*. The former concerns *teate* determined by each organisation. The latter concerns *teate* regulated by laws.

Teiki shoukyu

Elements of annual pay increases in Japan are divided into *base-up* and *teiki shoukyu*. *Teiki shoukyu* concerns the pay increases of individuals, not those across the firm. *Teiki shoukyu* is applied to all employees regardless of the financial situation of the firm and, in theory, personal characteristics and individual contribution. However, in practice, the pay increase rate usually differs among employees according to factors such as age, years of service, academic background and individual contribution. Type of *teiki shoukyu* is divided by *jidou shoukyu* (automatic pay increase by age and years of service), *satei shoukyu* (appraisal-related pay increase) and *shoukaku shoukyu* (pay increase related to grade promotion). This thesis translated *teiki shoukyu* as 'regular pay increase' in English.

Zokujinkyu

Pay related to personal characteristics such as age, years of service and academic background.

Zokujinteki youso

Personal characteristics such as age, years of service and academic background.